5.7 FISCAL SUSTAINABILITY

In the context of the City's General Plan update, the primary goal of the fiscal impact analysis is to quantify the impact of the three alternatives on the City's long-term fiscal health to help formulate policies, growth patterns, and public service standards that are fiscally sustainable over the General Plan buildout.

METHODOLOGY

The fiscal impact analysis is focused on the City's General Fund budget, comparing the costs of providing public services and maintaining public facilities with the primary revenue sources available to cover these expenditures. The fiscal impact analysis is based on a review of the current Fiscal Year 2021/22 budget as well as correspondence with City staff.[36] As noted, this analysis is designed to inform key planning and policy parameters associated with the General Plan Update. The information will be used to craft a preferred General Plan alternative that is fiscally sustainable over the long-term.

It is important to stress that this analysis is being provided to compare the relative fiscal implications of the three General Plan alternatives and not for actual budgeting purposes. Thus, the results will not and should not be used as a basis for making actual, department level staffing decisions or annual revenue estimates. It should also be noted that the fiscal results (annual surpluses or deficits) are simply indicators of fiscal performance; they do not mean that the City will automatically have surplus revenues or deficits because the City must have a balanced budget each year. Persistent shortfalls shown in a fiscal analysis may indicate the need to reduce service levels or obtain additional revenues; persistent surpluses will provide the City with resources to reduce liabilities such as deferred maintenance, improve service levels, or build up reserves.

[36] More detailed interviews with City staff, specifically the Fire Department and the Public Works Department are needed.

In addition, the findings are based on a set of "baseline" conditions and assumptions related to the key factors that affect General Fund costs and revenues, such as property assessed value, sales tax levels, state and federal budget and tax policy, and other factors. To the degree that these conditions change, the fiscal performance of new growth will differ from the estimates provided herein.

SUMMARY OF FINDINGS

Over time, and assuming full buildout, all three of the General Plan alternatives are estimated to generate more General Fund revenues than expenditures under the City's current cost structure and service levels. Alternatives A and B reflect the most fiscally advantageous outcome for the City's General Fund while Alternative C is relatively less fiscally favorable. These additional annual General Fund net surpluses range from $5.2 million to $8.1 million, as illustrated in Table 28, representing a 4 to 6 percent increase over the existing budget. Thus, implementation of any of the General Plan alternatives may allow the City to improve its service levels and standard by varying degrees over time.[37]

The improved fiscal performance projected to result from the implementation of each of the General Plan alternatives stems, in varying degrees, from (1) an increasing orientation towards higher-value development and (2) economies of scale in the provision of public services. Accordingly, for each of the alternatives, the highest revenue sources are related to Property Tax. Simply put, newer and larger buildings tend to be worth more than older and smaller buildings and, therefore, generate more property tax revenue. In terms of department-level costs, Police and Fire make up the majority of General Fund costs (approximately 60 percent of total expenditures), followed by Parks, Public Works, and general government functions.

As noted in the previous Public Services section, most City departments indicate the potential need for new public facilities and additional staff to serve new development under each alternative. This analysis assumes current staffing service standards (i.e., sworn officers per resident equivalent) and operating cost ratios are maintained as the number of residents and employees increase in response to the growth in the service population. However, this analysis does not estimate one-time capital costs associated with new facilities.

Table 28 Fiscal Impact Summary of General Plan Alternatives

Item	Annual Fiscal Impact		
	Alternative A	Alternative B	Alternative C
General Fund Revenues			
Property Tax - Secured	$22,140,000	$26,760,000	$31,880,000
Sales Tax – Local 1%	$2,710,000	$3,450,000	$4,300,000
Sales Tax – 1/4 % Measure S[1]	$710,000	$910,000	$1,130,000
Property Transfer Tax	$2,530,000	$3,440,000	$4,510,000
Business License Tax	$1,810,000	$1,810,000	$1,760,000
Franchises	$910,000	$1,140,000	$1,410,000
Recreation Service Charges	$610,000	$830,000	$1,110,000
Permits, Fees, and Fines	$1,480,000	$1,930,000	$2,460,000
Total Revenues	**$32,900,000**	**$40,270,000**	**$48,560,000**

[37] The fiscal impact analysis indicates that each alternative will generate net positive fiscal revenue each year at General Plan Buildout. If economic or regulatory conditions change or if development does not materialize as planned, the City may need to consider fiscal mitigation strategies. Such strategies could include Community Facilities Districts or other public financing mechanisms.

Item	Annual Fiscal Impact		
	Alternative A	Alternative B	Alternative C
General Fund Expenditures			
City Attorney	$80,000	$100,000	$130,000
City Clerk	$60,000	$70,000	$90,000
City Council	$20,000	$30,000	$40,000
City Manager	$170,000	$220,000	$280,000
Community Development	$260,000	$330,000	$430,000
Finance	$280,000	$360,000	$460,000
Human Resources	$160,000	$210,000	$270,000
Information Technology	$290,000	$370,000	$470,000
Library	$1,770,000	$2,420,000	$3,220,000
Parks and Recreation	$4,100,000	$5,590,000	$7,430,000
Police	$8,750,000	$11,350,000	$14,510,000
Public Works	$2,780,000	$3,800,000	$5.050,000
San Mateo Consolidated Fire Dept. Contribution	$6,060,000	$8,280,000	$11,000,000
Total Expenditures	**$24,780,000**	**$33,130,000**	**$43,380,000**
Net Annual Fiscal Impact	**$8,120,000**	**$7,140,000**	**$5,180,000**

Note: Property Tax in-Lieu of Motor Vehicle License Fee (VLF) is estimated to generate between $3.8 million and $5.4 million at General Plan buildout. However, it is not included in this analysis due to current concerns regarding the certainty of the revenue source.

[1] Although Measure S Sales Tax revenues are treated separately from the Local 1% Tax, they are included in this analysis to facilitate full evaluation General Fund resources

Analysis by Economic & Planning Systems, Inc.

The relative performance of various General Plan alternatives is driven by a variety of complex factors, the most notable of which is the type and amount of development envisioned in each and the resulting service populations. Given the current profile of General Fund expenditures in the City, nonresidential development performs better than residential development because residents and residential uses generate higher demand for public services than do businesses and their employees. However, high residential real estate values in San Mateo result in higher-than-typical property tax-related revenue that partially offsets the public service expenditures. Given these and other factors, Alternative C is expected to generate the highest revenues as well as the highest public service costs. Alternative B generates the second highest revenues and the second highest costs. Alternative A reflects the lowest population and employment growth and generates the lowest revenues and the lowest costs.

Retail development can generate sales tax revenue, however, for this analysis, EPS forecasted the sales tax to the City's General Fund based on demand from population and employment growth rather than new retail development. This is a conservative approach in order to ensure that the analysis is based on internal growth dynamics rather than an assumption that "supply creates demand," particularly given ongoing trends towards online retail. Depending on the performance of regional retail developments and each retailer's ability to capture regional demand, there could be positive sales tax revenue associated with each alternative that is not estimated in this analysis.

POLICY CONSIDERATIONS

The key General Plan related policies and issues that may be informed by the Fiscal Impact Analysis include, but are not necessarily limited to, the following:

- **Public service levels and standards:** The level of service provided by various departments is often quantified based on standards or ratios (i.e., sworn police officers per 1,000 service population for police, park acres per 1,000 population, etc.) related to either articulated goals or actual conditions. The fiscal analysis can be used to highlight the fiscal implications of "business as usual" relative to alternative ways of providing services.

- **Tax and fee rates:** The General Plan can also articulate various goals or standards related to financing mechanisms and requirements to ensure fiscal sustainability, promote economic development, and other objectives.

5.8 MARKET FEASIBILITY

This financial feasibility analysis provides a planning-level assessment of development feasibility for a range of residential, office, and retail commercial development prototypes at varying densities. These uses will be the essential drivers of the new residential and employment capacity supported by the General Plan Update. Table 29 summarizes the results of the financial feasibility analysis.

Mixed-use development, a unique land use category, is a significant component of each alternative. However, it allows so much flexibility that it is difficult to evaluate a single prototype project that adequately represents all of "mixed use". Rather, the feasibility of mixed-use development is better evaluated as "residential" or "office." For current planning purposes, ground-floor retail contained within residential and office projects has a negligible effect on financial feasibility. It likely can be integrated into mixed-use projects as a revenue-neutral amenity. Other types of potential development not considered here include public and cultural amenities.

Solving for residual land value, the financial feasibility analysis offers a static perspective on whether revenues from a completed, fully-occupied project are sufficient to justify development costs. "Residual land value," the key determinant of feasibility, is the difference between a project's value and estimated development costs and represents the amount a project developer could pay a landowner for the project site. Land acquisition is a critical component of the development process. The residual land value must be sufficiently positive that the developer can pay to purchase the land. In cases where a current landowner is contemplating redevelopment, the residual land value must be sufficient to warrant the costs of redevelopment (e.g., buying out existing leases, demolition, etc.).

While land values will fluctuate over time and based on parcel-specific circumstances, for purposes of this analysis, feasibility requires a threshold residual land value of $5 million per acre or greater. A residual per acre land value of between $3 million and $5 million is considered potentially feasible, while a residual land value below $3 million per acre means the project is not feasible.

Development cost assumptions vary by prototype based on land use type, density, height, parking requirements, etc. Direct construction costs are related to construction types based on fire-resistance rating requirements codified by the California Building Code. Type V buildings are relatively simple, inexpensive, and uncomplicated to evacuate in case of fire. They are made of exterior and interior wood construction

Table 29 Near-Term Development Feasibility

Land Use and Density Prototype	Residual Land Value (per Acre)	Feasibility Indicator
Residential		
Low	$3,400,000	Maybe
Medium	$12,100,000	Yes
High	$1,300,000	Not Now[1]
Office		
Low	$5,150,000	Yes
Medium	$30,400,000	Yes
High	($42,930,000)	Not Now
Commercial		
Neighborhood	$3,180,000	Maybe
Service	$5,200,000	Maybe
Regional	($410,000)	Not Now

Note: A feasibility indicator of "Yes" occurs with a residual land value of $5 million per acre or higher. An indicator of "Maybe" occurs with a residual land value of between $3 million and $5 million per acre. An indicator of "Not Now" means the residual land value is negative or too low to acquire land and/or overcome the redevelopment barrier.

[1] Structured rather than subterranean parking would push the high-density residential prototype toward feasibility.

Analysis by Economics & Planning Systems, Inc.

and can reach 60 feet in height. Type III buildings, typically wooden structures situated atop concrete podiums, allow for more height and density. They can reach 65 to 85 feet in height. Type I buildings are significantly taller and accommodate more occupants than Type III and Type V buildings. Therefore, they require more fire-resistant and more expensive material than wood. They are made of concrete and steel and can exceed 75 feet in height.

Parking is another important development cost factor, with costs ranging from about $5,000 per space for surface parking to $65,000 per space for belowground parking. Surface parking is at-grade and paved, typical for neighborhood and service commercial retail. Surface parking is the least expensive to provide but requires sufficient land to accommodate the parking. Parking structures are situated above ground, sometimes as stand-alone parking garages and sometimes with residential or office uses above. They are generally expensive to construct but may make more efficient use of the land than surface parking. Subterranean, or belowground, parking is expensive to build because it requires site excavation.

This feasibility analysis reflects that the alternatives will build out over a 20-year horizon, so it does not consider potential development timing, market absorption, or the current regulatory context. For example, higher-density development may not be feasible today, both in light of current real estate market conditions and Measure Y height and density limits, but likely is a longer-term opportunity that will become more feasible between now and 2040.

There are a number of additional analytical caveats that affect financial feasibility in this analysis:

- The 10 General Plan Study Areas will require public realm investments to achieve their full potential. The development costs considered in the analysis include unique costs associated with new streets and infrastructure connections, though estimates are highly preliminary.
- The analysis focuses on individual prototype projects. The timing of revenues and timing of costs for infrastructure are beyond the scope of this analysis.
- The analysis does not seek to analyze prototype development on any particular site. Unique and challenging redevelopment projects such as those contemplated on key sites in San Mateo will require strategic execution. To achieve financial feasibility, successful redevelopment projects will require expert market positioning, branding, promotion, and operations.

This alternatives evaluation was prepared as the nation and world continue to address the coronavirus pandemic, an unprecedented public health crisis. Research for this memorandum was completed as the Bay Area, generally, appears to be emerging from the worst of it. However, given that the length and severity of the coronavirus pandemic may still not be fully known, economic implications will depend fundamentally on how the crisis unfolds. The current consensus is that negative economic impacts are likely to dissipate gradually, although the exact pace and timeframe for full economic recovery remain unclear. This analysis assumes that the General Plan buildout may take several decades. In this time, the recent effects of the coronavirus pandemic, which accelerated trends relating to the demand for office and commercial uses (e.g., gig economy, remote work, online shopping, etc.), likely will be superseded by other social and economic trends that are difficult or impossible to predict.

SUMMARY OF FINDINGS

Based on current market rents and current development costs, the mix of land use and density designations suggest Alternative B offers the greatest potential for near-term development feasibility due to the current feasibility of most midrange-height developments, followed by Alternative C and then Alternative A.

The medium-density residential and low- and medium-density office prototypes appear feasible under current market conditions. The low-density residential and the neighborhood and service retail commercial prototypes may be feasible depending on the cost of the land. Currently, residual land values for high-density residential and high-density office are negative or barely positive, so these development types are currently not feasible. However, a less expensive structured parking solution rather than costlier subterranean parking would push the high-density residential prototype toward feasibility.

- For residential developers, medium-density development appears feasible, while lower-density development may be feasible depending on land costs. High-density residential development is not feasible at this time but could be with a more cost-effective parking solution (e.g., structured rather than subterranean).

- The medium-density residential prototype (four to seven stories) maximizes residential real estate feasibility under current market conditions. The analysis shows that residential towers (8+ stories) likely are currently financially infeasible; however, additional height allowances could be desirable in the future, should values increase relative to costs. The medium- and high-density prototypes support nearly identical rental income per square foot, but high-density development costs are significantly higher as the construction type transitions from Type V to Type I. For low-density residential development (defined as one to three stories), the residual land value is positive but may not be sufficient given current land values.

- Current market conditions support low- and medium-density office development but do not yet support high-density office of more than eight stories.

- Revenue potential and current development costs support the near-term feasibility of low- and medium-density office development. In contrast, the rent premium for high-density office in San Mateo is insufficient to justify the much higher development costs associated with Type I office construction, the parking ratio requirement, and the subterranean parking that likely would be necessary.

- The neighborhood and service retail commercial development prototypes generate positive residual land values under current market values, which may support redevelopment of an existing property but do not justify land/property acquisition.

- Neighborhood and service retail commercial may be feasible, depending on the specific circumstances of the developer. If the developer is also the landowner, redevelopment of the site may be feasible, but if a developer needs to purchase the land, the residual land value may not be enough to incentivize the current landowner to sell. Regional retail development faces the additional barrier of high structured parking costs. Providing parking is expensive in general, and the amount needed for large regional shopping centers limits financial feasibility. Structured parking comprises 28 percent of total construction costs for the Regional commercial prototype, while surface parking comprises just 5 percent of total construction costs for the neighborhood and service retail commercial prototypes, making these prototypes relatively more feasible.

- For those prototypes that face feasibility challenges under current market conditions, improving real estate economics will require shifts in the relative costs and revenues during the next 20 years to push these development prototypes towards feasibility.

- Historically high development costs are creating feasibility challenges for the higher-density office and residential prototypes under current market conditions because construction costs have outpaced rent growth and revenue potential. While this trend is not new (rent growth has not outpaced construction costs for at least the past 10 years[38]), the dynamic worsened during COVID. While construction costs (labor and materials) are expected to moderate post COVID, creative approaches to reducing costs are needed. More specifically, subterranean parking significantly increases development costs and is not a realistic option in many cases. Planning parameters established for higher-density uses should contemplate above-ground, cost-effective parking solutions that multiple properties can share. Reducing parking requirements near transit and taking measures to reduce parking demand are alternative options for reducing costs. Lastly, alternative construction technologies, such as green construction, could maximize resource efficiency and reduce overall costs.

- Overall, Alternative B appears to be more feasible under current conditions because it includes more midrange, medium-density prototypes across the 10 study areas relative to Alternatives A and C.

- However, developing many sites with midrange heights and at medium densities in the near term would make it less likely that those sites would redevelop with higher-density development later on, even if high-density development becomes more feasible between now and 2040 due to changes in market conditions.

5.9 COMMUNITY BENEFITS

California cities have a long history of obtaining community benefits from real estate development through a variety of mechanisms, including fees, conditions of approval, and Development Agreements (DAs). Today, throughout California, new community benefits programs are establishing defined approaches to ensuring community benefits from real estate development projects.

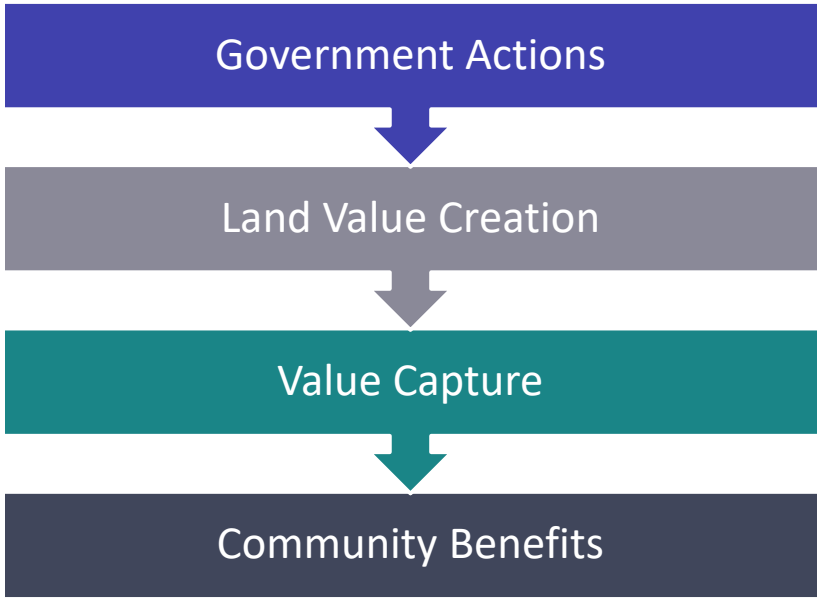
COMMUNITY BENEFITS DEFINED

Community Benefits as defined here are contributions to the broader community, including but not limited to on-site benefits (e.g., affordable housing, day care facilities, community rooms) and off-site benefits (e.g., parks, transportation improvements). Projects may seek to deliver these community benefits directly. Alternatively, community benefit obligations also may be satisfied through monetary contributions to the City which accrue to a "Community Fund" to be dispersed as appropriate for the provision of community benefits within the City of San Mateo.

Community benefits typically are achieved through an exchange in which municipalities offer optional increases in development potential in return for public assets (or funds) desired by the community. The incentive for the private sector to provide community benefits comes from the value that is created when a local jurisdiction entitles increased development density or provides other entitlement enhancements that increase the economic potential of a project. In order for extraordinary community benefits to be viable, entitlement enhancements must be above what normally would be allowed (i.e., a "bonus," amendment, variance, or vested rights). The magnitude of the community benefit required by the local jurisdiction must be equal to or less than the value of the incentive offered, otherwise developers will not seek entitlement enhancement.

[38] Determined using cost trends from the California Construction Cost Index from the California Department of General Services, and CoStar Group.

The current City of San Mateo General Plan provides a high-level framework for the provision of community benefits. For multifamily residential development, the Plan allows "a range of densities from 9 to 50 units net per acre, with the higher end of the density range to be used only for projects which provide substantial public benefits or amenities." For non-residential uses, a Floor Area Ratio (FAR) range of 0.5 to 3.0 and height range of 25 to 90 feet is permitted, with the higher ends of both ranges "only for projects which provide public benefits or amenities substantially greater than code requirements."[39] The Plan also allows specific areas of the Downtown and Mariner's Island densities of up to 75 units per acre and heights up to 75 feet for projects which provide public benefits or amenities substantially greater than code requirements.



While the General Plan provides this direction concerning projects that require community benefits, specific threshold triggers have not been established and the City lacks a standardized process for determining community benefits requirements.

THE CONCEPT OF VALUE CAPTURE

Cities and government agencies create real estate value with investments in public facilities and services (e.g., transit and utilities upgrades) as well as through changes to zoning code that increase the value of land. Typically, when the public sector creates value in these ways, landowners enjoy a financial gain in the form of higher land value, which is realized when they sell or develop their land. This increase in land value is an unearned financial benefit that accrues to the private sector, though it is generated (and commonly paid for) by tax-payer funded public entities. The term "value capture" reflects the situation in which the public sector recovers some of this unearned value created for the private sector through public sector activities.

Zoning modifications and other entitlement enhancements require a healthy real estate market with sufficient market value to support the incentives. In order for a city to capture value from a density incentive or other incentive, there must be market demand to support the real estate products (typically higher-density, higher-cost) that are provided for through the zoning modification. If the public sector seeks to collect more value than is created it is unlikely that project proponents will move forward. Since the value of development incentives varies with market conditions, development incentives may be very valuable in a strong market but of lesser or no value in a weak market. Some community benefits programs seek to be highly responsive to changing market conditions.

[39] Note that Measure Y limits development heights to 55 feet, with certain exceptions. Exceptions include development within the Hillsdale Shopping Center (Study Area 10) and some specific areas of Downtown (Study Area 4) where building heights of up to 60 feet and 75 feet may be allowed, respectively.

Community benefit requirements should be calculated to reflect the value of zoning modifications made available by the public sector. A pro forma financial analysis that estimates value creation resulting from zoning changes, over and above what zoning allows by right, offers a defensible approach to quantifying required community benefit contributions. To accurately estimate value creation, the analysis should reflect development challenges that may exist (e.g., site constraints, infrastructure shortcomings, required mitigations). Also, projects with a relatively high land cost may be financially unable to compensate the City for the full value increase generated by the desired zoning modification. In these circumstances, the City may choose to scale community benefits obligations in order to maintain the financial viability of the project as proposed.

The magnitude of the public benefit sought must be equal to or less than the value of the incentive or entitlement enhancement offered. In order for community benefits programs to work financially, the public sector must create value through the provision of increased development potential, commonly provided as increased project density and/or height. If the public sector seeks to extract more value than is created, it is unlikely that project applicants will pursue a zoning modification. Since the value of development incentives varies with temporal market conditions, development incentives may be valuable in a strong market but of lesser value or without value in a weak market. Community benefits programs that rely on project-specific financial analysis to determine benefits requirements are responsive to changing market conditions, but it remains likely that these programs will not be used during periods of market weakness.

As noted above, the type, amount, and value of community benefit that the City can extract from private development will vary dramatically based on the type of project, specific site conditions, and market conditions at the time of development. While Alternatives A and B may leave more development potential (i.e., height and density) to negotiate community benefits than Alternative C, it is not possible to make an accurate prediction of how community benefits will play out under each alternative over the 20-year timeframe of the General Plan.

POLICY CONSIDERATIONS

In the past, zoning modifications and benefits have been negotiated on a project-by-project basis, which has proved to be an opaque and time-consuming course. The updated General Plan may want to provide further direction.