OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 2

Additional Analysis Regarding an Increase to CCDC Tax Increment Limit

OVERVIEW

On April 27, 2010, the Redevelopment Agency Board considered a request to authorize the Centre City Development Corporation (CCDC) to proceed with preparing required documentation for a potential amendment to the Centre City Redevelopment Plan for the purpose of increasing the tax increment limit ("cap") for the Centre City project area.

Prior to the April 27 meeting, the IBA released Report No. 10-36, providing specific analyses with respect to the potential impact that a cap increase may have on General Fund property tax revenue, as requested by Councilmember DeMaio in a January 13 memorandum to our office. While the report concluded that increasing the tax increment cap could result in a net reduction of property tax revenue to the General Fund, it also noted that such an analysis only illustrated one side of the equation. Other factors, such as the General Fund benefit of future projects and activities, and the increased revenue from sales tax and TOT that may result from continued downtown redevelopment, should also be taken into consideration.

The requested authorization to proceed was continued by the Redevelopment Agency Board until the meeting of June 22, 2010. On May 24, Council President Pro Tem Faulconer issued a memorandum to the IBA requesting additional analysis regarding an increase to the Centre City Redevelopment Project tax increment cap. This report is provided in response to that request.

FISCAL/POLICY DISCUSSION

On April 23, 2010, the IBA released Report No. 10-36, providing an analysis of the potential impact to General Fund property tax revenues as a result of an increase in the tax increment cap for the Centre City Project Area. This report was provided in response to a January 13 memorandum from Councilmember DeMaio that requested the IBA provide a fiscal analysis of the proposed cap increase.

Based on assessed valuation growth projections developed by CCDC, IBA Report 10-36 concluded that increasing the tax increment cap to a hypothetical level of $9 billion (from the current level of $2.98 billion) would result in a cumulative net reduction in General Fund property tax of over $300 million from FY 2011 to FY 2043. However, the report noted that this analysis only provides one side of the equation, and that a number of other factors should also be taken into consideration, including the General Fund benefit of future projects and activities to be completed; the potential ancillary economic benefits from continued redevelopment, such as increased sales tax, transient occupancy tax, employment and business activity; and the increased funding for affordable housing.

On May 24, 2010, Council President Pro Tem Faulconer issued a memorandum to the IBA requesting additional analysis regarding a potential increase in the tax increment cap for the Centre City Redevelopment Project. This report responds to the questions posed in the memorandum as follows:

1. **What is the current dollar estimate of outstanding projects identified in the Downtown Community Plan? By what dollar amount does this exceed CCDC's projected revenues?**

   The Downtown Community Plan, adopted in March 2006, contains numerous anticipated projects, many of which have not been completed. According to a June 15, 2010 letter from CCDC to Council President Pro Tem Faulconer, the estimated cost of these projects could approximate $1.6 billion. A list of projects and estimated costs are provided as Attachment D to the CCDC letter. However, as the letter states, this list is not all inclusive, and a thorough analysis will be performed as part of the report that will be prepared as part of the current request for authorization to proceed.

   The current tax increment limit established in the Centre City Redevelopment Plan is $2.894 billion. Through June 30, 2009, CCDC has collected approximately $794 million. However, after allocating the required 20% for affordable housing, and deducting known future commitments such as tax sharing payments, debt service and administration costs, CCDC estimates that $386 million will remain for project implementation. Using these figures, the approximate value of the remaining projects identified in the Downtown Community Plan could exceed available tax increment revenues by approximately $1.214 billion.

2. **Given past ancillary development in Downtown, would you please provide your best analysis of what future ancillary development will occur if the CAP is lifted?**

   The Fiscal Year 2011 Budget for the Centre City and Horton Plaza Redevelopment Projects includes metrics on the economic gain from redevelopment. According to these metrics, downtown has seen $12.8 billion in private investment over the past 35 years, compared to $1.54 billion in public investment, reflecting a private/public investment ratio of 8.4:1.

   Based on growth projections developed by CCDC, IBA Report 10-36 presented two scenarios for future assessed valuation downtown, one assuming a cap increase and one assuming no cap increase. Under the no cap increase scenario, gross assessed valuation was projected to be $35.3 billion by FY 2043. Under the cap increase scenario, assessed valuation was projected to reach $62.5 billion, a difference of approximately $27.2 billion. This difference in growth in assessed valuation reflects anticipated higher levels of private investment in the cap increase scenario. Adjusting for annual inflation at 3%, this results in total additional private investment of approximately $10.6 million in today's dollars as a result of the cap increase.

   It should be noted that this projection is based solely on the hypothetical growth rates developed by CCDC under the cap increase and no cap increase scenarios. As expected, assessed valuation is projected to experience stronger growth under the cap increase scenario. However, the growth projections in this scenario are somewhat conservative given the historical growth in assessed valuation downtown.

3. **How much in increased revenues to the General Fund can we expect from increased sales tax and transient occupancy tax if the CAP is lifted?**

   Projecting the increase in sales tax and transient occupancy tax (TOT) revenue that would result from raising the tax increment cap is very difficult. While redevelopment can stimulate economic activity, it is just one of many factors that influence overall economic growth within the City. For example, redevelopment can result in the building of new hotels, but growth in the lodging industry is largely dependent on tourism marketing and promotion. Similarly, redevelopment can result in the creation of retail centers, but consumer spending is driven by income growth. More formal and rigorous analysis would be required to understand the interaction between redevelopment a myriad of other economic variables.

   The revenue projections presented below reflect the potential increase in sales tax and TOT revenue that may result from future development of hotel rooms and retail space downtown. However, what cannot be determined without significant further analysis is how much of this future growth and development is dependent upon a cap increase, and the degree to which future growth downtown reflects a net increase in economic activity, or just a reallocation of activity from other areas of the City. In order to mitigate for these factors, a conservative approach has been used in projecting potential increases in sales tax and TOT revenue.

Sales Tax

According to the Downtown Community Plan, as of August 2004 a total of 2,658,000 square feet of retail space had been developed, with an additional 679,000 square feet in the pipeline. At build out, the Community Plan projects a total of 6,070,000 square feet of retail space. Assuming that the pipeline retail development has been completed, an additional 2,733,000 square feet of retail space may be feasible. Assuming a conservative average of $175 in annual gross sales per square foot, and a 3% annual inflation factor, development of an additional 2.7 million square feet in retail space could result in a cumulative $156.8 million in increased sales tax revenue between FY 2011 and FY 2043. Even if only half of this future retail space is developed, the cumulative increase in sales tax revenue could total $78.4 million.

Transient Occupancy Tax

According to the metrics in the Economic Gain from Redevelopment section of CCDC's FY 2011 Budget, over 9,300 hotel rooms have been built in the Centre City project area. The Downtown Community Plan projects a total of 20,000 hotel rooms at build-out, suggesting that over 10,000 additional hotel rooms may be feasible. However, CCDC has developed projections of future TOT revenue using more conservative assumptions of 3,000 and 4,000 new rooms. Utilizing data from Smith Travel Research on average occupancy rates and the average daily room rate, including an annual inflationary factor, these projections suggest that the addition of 3,000 hotel rooms could result in a cumulative $281 million increase in TOT revenue, while 4,000 new rooms could result in a cumulative $375 million increase.

4. What is the expected net impact to the General Fund?

Given the preliminary nature of the cost estimates for remaining projects downtown, as well as the inherent difficulty in projecting increases in tax revenue, the net impact to the General Fund of raising the tax increment cap cannot be quantified with any precision at this time.

As discussed in the June 15 letter from CCDC, the consultant studies that will be completed in preparation for a potential cap increase will include, among other things, the estimated cost of the projects and programs proposed to remove blight, an explanation of why the private sector acting alone or without redevelopment could not redevelop the area, and a projection of future tax increment revenues. These factors will be critical in quantifying the net impact to the General Fund.

It should also be noted that the net impact to the General Fund of an increase in the tax increment cap depends on the timeframe being considered. As described in the response to Question 2 above, growth in assessed valuation is expected to be significantly higher with a cap increase than without. As a result, once the Centre City Redevelopment Plan terminates in 2043, the General Fund and all other taxing agencies will benefit from the higher property taxes revenues that result from the more significant growth in assessed valuation.

While the net impact to the General Fund cannot be accurately quantified at this time, based on the projected higher long-term growth in assessed valuation, the value of future projects to be completed, and the likely benefit from increased sales tax and TOT revenue, we believe that an increase in the tax increment cap will be a net positive to the General Fund over the long-term.

CONCLUSION

This report is provided in response to the May 24, 2010, memorandum from Council President Pro Tem Faulconer requesting additional analysis regarding a potential increase in the tax increment cap for the Centre City Redevelopment Project. While the analysis provided in IBA Report No. 10-36 indicated that a cap increase could result in a cumulative $300 million reduction in General Fund property tax of from FY 2011 to FY 2043, this report illustrates the potential General Fund benefits of a cap increase, including the value of future projects to be completed by the Agency, the projected increase in private investment, and the potential increase in revenue from sales tax and TOT.

As a result of these factors, and the future property tax benefit due to anticipated higher growth in assessed valuation, we believe that increasing the tax increment cap will be a net positive for the General Fund over the long-term. However, additional analysis is required to more precisely quantify these financial impacts. As such, we support the requested authorization to proceed with the necessary consultant studies and reports in preparation of a proposed amendment to the Centre City Redevelopment Plan.

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Tom Haynes Fiscal & Policy Analyst	APPROVED: Andrea Tevlin Independent Budget Analyst