REVIEW OF THE JOHNSON DRIVE ECONOMIC DEVELOPMENT ZONE

PREPARED FOR PLEASANTON CITIZENS FOR RESPONSIBLE GROWTH

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Civic Economics
www.CivicEconomics.com

For more information, contact:
Dan Houston, Partner
dhouston@CivicEconomics.com
512.853.9044

CIVIC ECONOMICS
CREATIVITY · OPPORTUNITY · PROSPERITY

Economic Analysis and Strategic Planning for Sustainable Prosperity

INTRODUCTION

Civic Economics was retained by Pleasanton Citizens for Responsible Growth to provide an outside review of various aspects of the proposed Johnson Drive Economic Development Zone. Our work involved a review of existing documents prepared by or for the City of Pleasanton analyzing the likely economic activity and impact associated with the JDEDZ. Our work focused on the inclusion of a Costco store because (a) it is the primary driver of sales in the project, (b) its sales is the source of revenues to repay a portion of the infrastructure investment, and (c) its presence is the reason for most of that infrastructure need.

The JDEDZ is made up of several parcels of land along Johnson Drive, near the junction of Interstates 590 and 680. Vehicle access to the site is currently sized for its former uses, including an R&D facility for Clorox, but the key feature of the proposed development is a Costco warehouse store of 148,000 square feet located well into the site. Thus, the JDEDZ calls for infrastructure improvements needed make the site suitable for large format retail, costing an estimated $21.5 million.

The city has proposed to fund these improvements through a mixed package including the following:

- Existing TIF funds of $6.4 million would enhance onramps at Stoneridge Drive and I 680. According to the city's Capital Improvement Program budget for 2017/18, these funds will only be expended if the rest of the JDEDZ project comes together. Otherwise, it will be redirected to other projects the city has deemed necessary.
- Costco is said to be contributing $6.8 million in cash. Some of that is in the form of donated right of way on Costco land to facilitate access to Costco. Another $3.7 million of that is the amount Costco would be required to contribute to the TIF pool independent of the JDEDZ project.
- Finally, another $6.8 million is proposed as a loan from Costco to the city, to be repaid over up to 25 years by rebating 40% of the sales tax revenue from the store until the principal and interest (at 1.5% per year) is repaid. Additional amounts may be added to this loan at no interest for right of way acquisition.

Costco operates in the warehouse club sector of general merchandise retailing. It has 506-and-counting US locations and more than 200 international locations. The chain has a heavy presence in California, with 122 stores including Danville (8.4 miles from the JDEDZ site) and Livermore (7.3 miles).

Civic Economics Analysis

Our key findings are as follows:

I: Costco Sales Forecasts

Both city consultants, Century Urban (conducted in 2015) and ALH (2016), overestimate likely Costco sales based on a mix of outdated data and optimistic forecasting.

II: Sales Tax Revenue Sharing Repayment

As a result, the city's anticipated ability to make Sales Tax Sharing payments is in doubt, and its expectation of surplus sales tax revenues is inflated.

III: Other Funding Sources for JDEDZ

Of the other public funding sources for JDEDZ development, as much as $10.1 million in TIF funding is diverted from other pressing city transportation needs.

IV: Impact on Pleasanton Retail Market

ALH understates the impact of the JDEDZ on the Pleasanton retail market by (a) overestimating the size and growth of that retail market and (b) ignoring ongoing trends in the retail industry.

In sum, the current JDEDZ proposal asks the City of Pleasanton to invest substantial public funds in a costly, long-term, speculative venture in a rapidly changing industry, and to do so based on erroneously optimistic forecasts of costs and benefits. City Council and the citizens of Pleasanton must demand better information before making such a momentous investment and developing this key tract of land.

I: COSTCO SALES FORECASTS

Civic Economics first undertook to analyze the assumptions underlying the proposed payment schedule by revisiting forecasts of sales and sales tax revenues associated with the Costco. In this section, we do not evaluate whether sales and thus sales tax revenues are truly new to Pleasanton; that is discussed in Section III.

It appears the City of Pleasanton has twice contracted for outside assistance in studying the finances of the JDEDZ proposal:

Figure 1

JDEDZ COSTCO SALES ESTIMATES BY CITY CONSULTANTS (2015 Dollars, Millions)

Consultant		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Century Urban		$ 135.0	$ 155.3	$ 170.8	$ 184.4	$ 193.7	$ 201.4	-
	Annual Growth		*15%*	*10%*	*8%*	*5%*	*4%*	
ALH Econ		$ 170.4	$ 175.5	$ 180.8	$ 186.2	$ 191.8	$ 197.5	$ 203.5
	Annual Growth		*3%*	*3%*	*3%*	*3%*	*3%*	*3%*

Sources:
For Century Urban: http://www.cityofpleasantonca.gov/civicax/filebank/blobdload.aspx?BlobID=30733
For ALH Econ: http://admin.cityofpleasantonca.gov/civicax/filebank/blobdload.aspx?BlobID=27508

Century Urban

Century Urban was retained to provide an analysis of the extent to which Costco (or the site developer Nearon) would be able to absorb the costs required to make the site ready for such intensive uses, which entailed creating a sales forecast.

Civic Economics has not been able to review the full Century Urban report, only its projections of Costco sales. The firm appears to have conducted its analysis when the most recent Costco annual report covered fiscal year 2014. Century Urban forecast that a Pleasanton store would generate first year sales 25% greater than the companywide average for stores opened in 2014. That produced an estimate of $135 million in the first year of operation. For subsequent years, annual sales increases appear to have been based on the optimistic assumption that slowing comparable store sales trends for Costco were an aberration. However, those trends have instead solidified in the years since.

Analysis

Costco stores consistently show a similar curve in same-store sales: the first year is well below company averages, subsequent years enjoy sizeable gains, and growth in out years flattens. This curve makes sense in the warehouse club market as area residents gradually purchase memberships and change shopping habits in early years, with a pronounced flattening in later years. The tables in Figure 2, drawn from Costco's own reporting, show this curve clearly.

Century Urban based its starting point on Costco's own reporting of first year sales across the company in 2014, as shown in the chart above. While the general shape of that curve remains, what has changed since 2014 is magnitude. While yearly gains in excess of 10% were once common through year five, the whole curve has flattened substantially in recent years. In the current environment, a reasonable analyst would forecast far lower annual gains for a Pleasanton Costco than did Century Urban.

ALH Urban & Regional Economics

ALH completed an economic impact study of the JDEDZ in March 2016, and it is this study that provides the inputs for the payment schedule above. ALH forecast that the Pleasanton Costco would generate sales equal to the corporate average sales per square foot for US stores, producing a first-year total of $170.4 million. ALH further forecast that sales would increase at a pace of 3% per year for at least the full 25 years of the agreement.

Analysis

The ALH impact study presents sales forecasts for a Pleasanton Costco that shows little connection to the data provided by Costco itself in its annual reports, instead building the analysis on a square footage basis.

ALH first assumes a Pleasanton store would come out of the gate achieving companywide average sales, an assumption that is clearly not supported by Costco data. Then, ALH forecasts a never-ending string of 3% annual sales gains, again without reference to what Costco stores achieve elsewhere.

A methodology based on the allocation and performance of square footage is not unusual for clients seeking a broad sense of the possibilities, and in this case the analysis proves highly useful in our subsequent analyses. However, in the case of Costco and in the high stakes game of repaying municipal debt, a more rigorous look at the retailer in question and the data it makes public would reveal the danger of this approach.

A More Realistic Costco Sales Forecast

Costco Annual Reports provide a helpful set of “Financial Highlights” charts each year, including a table entitled “Average Sales Per Warehouse” depicting the average performance of company stores by year opened and year of operation. Civic Economics has collected several years of these figures and calculated annual sales change on the following page. From these tables (Figure 2), we can begin to develop a forecast for a Pleasanton Costco.

Costco stores currently achieves average sales per store of $159 million; in the US, that figure rises to $171 million. However, as discussed above, individual store sales exhibit a characteristically slow start before ramping up and ultimately leveling off for the long haul. Indeed, company wide sales in 2016 were flat relative to 2015.

Year 1 Sales

Century Urban chose what seemed a reasonable and data-supported approach to forecasting first year sales of a Pleasanton Costco, which we have adopted here. They began with the company average first year store sales ($108 million in 2014) and added a generous adjustment of 25% on the assumption that the prosperous and expensive Bay Area market generates higher than normal sales, an assumption with which we agree. Using updated numbers from the 2016 Annual Report, we would estimate then that a Pleasanton Costco would achieve **first year**

Figure 2

COSTCO COMPARABLE STORE SALES BY YEAR OF OPERATION
$ Millions

Average sales by year opened

Year Opened	2008	2009	2010	2011	2012	2013	2014	2015	2016
2016									$ 87
2015								$ 83	$ 85
2014							$ 108	$ 109	$ 115
2013						$ 99	$ 109	$ 113	$ 116
2012					$ 105	$ 115	$ 124	$ 128	$ 130
2011				$ 103	$ 120	$ 130	$ 136	$ 139	$ 139
2010			$ 94	$ 106	$ 122	$ 135	$ 144	$ 148	$ 151
2009		$ 100	$ 107	$ 130	$ 146	$ 155	$ 157	$ 157	$ 155
2008	$ 86	$ 83	$ 99	$ 116	$ 128	$ 136	$ 144	$ 146	$ 147
2007	$ 88	$ 92	$ 103	$ 116	$ 127	$ 136	$ 143		
2006	$ 118	$ 114	$ 122	$ 127	$ 136	$ 145	$ 152		

Average sales by year of operation

Year Opened	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
2016	$ 87								
2015	$ 83	$ 85							
2014	$ 108	$ 109	$ 115						
2013	$ 99	$ 109	$ 113	$ 116					
2012	$ 105	$ 115	$ 124	$ 128	$ 130				
2011	$ 103	$ 120	$ 130	$ 136	$ 139	$ 139			
2010	$ 94	$ 106	$ 122	$ 135	$ 144	$ 148	$ 151		
2009	$ 100	$ 107	$ 130	$ 146	$ 155	$ 157	$ 157	$ 155	
2008	$ 86	$ 83	$ 99	$ 116	$ 128	$ 136	$ 144	$ 146	$ 147
2007	$ 76	$ 88	$ 92	$ 103	$ 116	$ 127	$ 136	$ 143	
2006	$ 92	$ 101	$ 118	$ 114	$ 122	$ 127	$ 136	$ 145	$ 152

Change by year of operation

Year Opened		Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
2016									
2015		2.41%							
2014		0.93%	5.50%						
2013		10.10%	3.67%	2.65%					
2012		9.52%	7.83%	3.23%	1.56%				
2011		16.50%	8.33%	4.62%	2.21%	0.00%			
2010		12.77%	15.09%	10.66%	6.67%	2.78%	2.03%		
2009		7.00%	21.50%	12.31%	6.16%	1.29%	0.00%	-1.27%	
2008		-3.49%	19.28%	17.17%	10.34%	6.25%	5.88%	1.39%	0.68%
2007		15.79%	4.55%	11.96%	12.62%	9.48%	7.09%	5.15%	
2006		9.78%	16.83%	-3.39%	7.02%	4.10%	7.09%	6.62%	4.83%
	3 year rolling average growth	4.48%	5.67%	3.50%	3.48%	1.36%	2.64%	1.75%	

Source: Costco Annual Reports, 2014, 2016

sales of $108.75 million dollars ($87 million company average plus a Bay Area adjustment of 25%).

Growth Rates

We next turn our attention to projecting sales growth in a Pleasanton Costco. As we have seen, Century Urban derived its forecast for growth from an optimistic reading of the then-current company data, anticipating a quick return to previously high growth rates, while ALH instead applied a seemingly arbitrary annual increase of 3% infinitely into the future.

We would propose that a more realistic forecast can be derived from the Costco data for comparable store sales over time, much as Century Urban did but using more current information from the 2016 Annual Report. In order to hew to the data we know to be reflective of reality, we have applied a three-year rolling average to growth rates through year eight of the store operation. That produces growth rates tightly in line with recent Costco performance as shown in Figure 2.

For the early years, we would note, we project growth rates higher than ALH. For out years, we have incorporated a growth rate of 0.5%, which is consistent with recent flattening Costco trends. Of course, predicting economic trends 25 years into the future is a highly speculative and dubious proposition. Where public debt is concerned, it might be seen as irresponsible to rely on optimistic forecasts out of line with current trends.

Figure 3

A MORE REALISTIC FORECAST		
3 Year Rolling Average Growth		
Year	**Growth Rate**	**Total Sales ($ Millions)**
1		$ 108.8
2	4.5%	$ 113.6
3	5.7%	$ 120.1
4	3.5%	$ 124.3
5	3.5%	$ 128.6
6	1.4%	$ 130.3
7	2.6%	$ 133.8
8	0.1%	$ 134.4
9	0.5%	$ 135.1
10	0.5%	$ 135.8
11	0.5%	$ 136.5
12	0.5%	$ 137.1
13	0.5%	$ 137.8
14	0.5%	$ 138.5
15	0.5%	$ 139.2
16	0.5%	$ 139.9
17	0.5%	$ 140.6
18	0.5%	$ 141.3
19	0.5%	$ 142.0
20	0.5%	$ 142.7
21	0.5%	$ 143.4
22	0.5%	$ 144.2
23	0.5%	$ 144.9
24	0.5%	$ 145.6
25	0.5%	$ 146.3

Figure 3 depicts the resulting forecast of Costco sales through 25 years.

The ALH Economic Impact Analysis report makes no mention of the rise of online retail and how it might impact Costco in particular. Rather, it assumes Costco will claim its share of the market and grow healthily into eternity. Costco's own data suggests that competitive factors, certainly including the internet, are impacting comparable store sales. And this is not the only portion of its study in which ALH ignored the impact of online retail; Section IV of this report addresses the impact of that oversight on forecasts of local market demand.

II: SALES TAX REVENUE SHARING REPAYMENT

The next step is to determine if these sales forecasts produce sufficient revenue to meet the obligations the City of Pleasanton is assuming in the JDEDZ Sales Tax Sharing Agreement with Costco.

The city and Costco have proposed to enter into a Sales Tax Sharing Agreement designed to repay Costco's $6.8 million upfront investment in infrastructure necessary to the development of the store plus 1.5% annual interest with a maximum term of 25 years. The agreement proposes to return to Costco up to 40% of the sales tax revenue associated with taxable revenue at the store, and does not include other retail facilities within the JDEDZ.

Taxable Sales

Civic Economics has not had the time to conduct its own assessment of Costco to estimate the proportion of total sales that will be subject to the city's 1% sales tax. Fortunately, ALH Econ did conduct such an analysis. We have no reason to believe that the mix of customers or of goods sold has changed in significant ways since ALH conducted its study, and thus have here adopted those analyses for the limited purpose of projecting sales tax revenues.

First, Costco is different from ordinary retailers in that many of its business members purchase goods from Costco for resale, and are thus exempt from paying sales taxes on those purchases. ALH estimated that **12%** of all revenue at the Pleasanton Costco would likely fall under an exemption from sales tax collection.

Secondly, Costco sells a broad selection of goods. Pharmacy and food are generally exempt from sales tax and gasoline is subject to its own tax regime. ALH estimated that **54.36%** of all sales at a Pleasanton Costco would be subject to city sales tax.

From that figure and the realistic sales forecasts developed in Section I, Civic Economics is able to project sales tax revenues from the Costco (Figure 4).

Figure 4

A MORE REALISTIC FORECAST
Sales and Taxable Sales

Year	Growth Rate	Total Sales	Taxable Sales
1		$ 108,750,000	$ 58,725,000
2	4.48%	$ 113,620,758	$ 61,355,209
3	5.67%	$ 120,059,419	$ 64,832,086
4	3.50%	$ 124,259,921	$ 67,100,357
5	3.48%	$ 128,582,116	$ 69,434,343
6	1.36%	$ 130,325,732	$ 70,375,895
7	2.64%	$ 133,761,718	$ 72,231,328
8	0.50%	$ 134,430,527	$ 72,592,484
9	0.50%	$ 135,102,679	$ 72,955,447
10	0.50%	$ 135,778,193	$ 73,320,224
11	0.50%	$ 136,457,084	$ 73,686,825
12	0.50%	$ 137,139,369	$ 74,055,259
13	0.50%	$ 137,825,066	$ 74,425,536
14	0.50%	$ 138,514,191	$ 74,797,663
15	0.50%	$ 139,206,762	$ 75,171,652
16	0.50%	$ 139,902,796	$ 75,547,510
17	0.50%	$ 140,602,310	$ 75,925,247
18	0.50%	$ 141,305,322	$ 76,304,874
19	0.50%	$ 142,011,848	$ 76,686,398
20	0.50%	$ 142,721,907	$ 77,069,830
21	0.50%	$ 143,435,517	$ 77,455,179
22	0.50%	$ 144,152,695	$ 77,842,455
23	0.50%	$ 144,873,458	$ 78,231,667
24	0.50%	$ 145,597,825	$ 78,622,826
25	0.50%	$ 146,325,814	$ 79,015,940

Repayment Schedule

Finally, we move on to evaluating whether these revenues are sufficient to meet the repayment schedule outlined in the proposed Sales Tax Sharing Agreement with Costco.

The City of Pleasanton is currently working under the assumption that the following table represents a reasonable forecast for how this agreement will work:

Attachment 3: Costco Sales Tax Share Analysis

Amount	**6,800,000**
Interest Rate	**1.50%**
Maximum Term	**25**

		Regular Payment Schedule				Prepayment Schedule (Based on Projected Costco Sales Tax Revenues)			
Fiscal Year	**Year**	**Principal**	**Interest**	**Total**	**Total Projected Costco Sales Tax Revenues**	**Principal**	**Interest**	**Total - 40% of Sales Tax**	**City Allocation - 60% of Sales Tax**
2019/20	1	$226,191	$102,000	$328,191	$926,709	$268,684	$102,000	$370,684	$556,025
2020/21	2	229,584	98,607	328,191	954,510	283,834	97,970	381,804	572,706
2021/22	3	233,028	95,163	328,191	983,146	299,546	93,712	393,258	589,887
2022/23	4	236,524	91,668	328,191	1,012,640	315,837	89,219	405,056	607,584
2023/24	5	240,071	88,120	328,191	1,043,019	332,726	84,481	417,208	625,811
2024/25	6	243,672	84,519	328,191	1,074,310	350,233	79,491	429,724	644,586
2025/26	7	247,328	80,864	328,191	1,106,539	368,379	74,237	442,616	663,923
2026/27	8	251,037	77,154	328,191	1,139,735	387,183	68,711	455,894	683,841
2027/28	9	254,803	73,388	328,191	1,173,927	406,667	62,904	469,571	704,356
2028/29	10	258,625	69,566	328,191	1,209,145	426,854	56,804	483,658	725,487
2029/30	11	262,504	65,687	328,191	1,245,419	447,767	50,401	498,168	747,252
2030/31	12	266,442	61,749	328,191	1,282,782	469,428	43,684	513,113	769,669
2031/32	13	270,439	57,753	328,191	1,321,265	491,863	36,643	528,506	792,759
2032/33	14	274,495	53,696	328,191	1,360,903	515,096	29,265	544,361	816,542
2033/34	15	278,613	49,579	328,191	1,401,731	539,154	21,539	560,692	841,038
2034/35	16	282,792	45,400	328,191	1,443,782	564,062	13,451	577,513	866,269
2035/36	17	287,034	41,158	328,191	1,487,096	332,686	4,990	337,677	1,149,419
2036/37	18	291,339	36,852	328,191	1,531,709				1,531,709
2037/38	19	295,709	32,482	328,191	1,577,660				1,577,660
2038/39	20	300,145	28,047	328,191	1,624,990				1,624,990
2039/40	21	304,647	23,544	328,191	1,673,740				1,673,740
2040/41	22	309,217	18,975	328,191	1,723,952				1,723,952
2041/42	23	313,855	14,336	328,191	1,775,670				1,775,670
2042/43	24	318,563	9,629	328,191	1,828,940				1,828,940
2043/44	25	323,341	4,850	328,191	1,883,809				1,883,809
Totals		**$6,800,000**	**$1,404,787**	**$8,204,787**	**$33,787,128**	**$6,800,000**	**$1,009,502**	**$7,809,502**	**$25,977,626**

Based on the rosy estimates provided by its consultants, built from a mix of outdated information and arbitrary assumptions, the City of Pleasanton is anticipating a relatively painless repayment of its obligations under the agreement. Indeed, the proposed schedule shows payments finishing up within 17 years, freeing the city to enjoy millions in new revenue from the Costco store.

However, a realistic analysis paints a more challenging picture:

Figure 5

SALES TAX SHARING AGREEMENT REPAYMENT SCHEDULE
Based Upon A More Realistic Forecast

TERMS OF AGREEMENT			
Amount	$	6,800,000	
Interest Rate		1.50%	annually
Term		25	years

Repayment	City Share
40%	60%

Year	Starting Balance	40% Sharing	Principal	Interest	60% to City
1	$ 6,800,000	$ 234,900	$ 132,900	$ 102,000	$ 352,350
2	$ 6,667,100	$ 245,421	$ 145,414	$ 100,007	$ 368,131
3	$ 6,521,686	$ 259,328	$ 161,503	$ 97,825	$ 388,993
4	$ 6,360,183	$ 268,401	$ 172,999	$ 95,403	$ 402,602
5	$ 6,187,184	$ 277,737	$ 184,930	$ 92,808	$ 416,606
6	$ 6,002,254	$ 281,504	$ 191,470	$ 90,034	$ 422,255
7	$ 5,810,785	$ 288,925	$ 201,764	$ 87,162	$ 433,388
8	$ 5,609,021	$ 290,370	$ 206,235	$ 84,135	$ 435,555
9	$ 5,402,786	$ 291,822	$ 210,780	$ 81,042	$ 437,733
10	$ 5,192,006	$ 293,281	$ 215,401	$ 77,880	$ 439,921
11	$ 4,976,606	$ 294,747	$ 220,098	$ 74,649	$ 442,121
12	$ 4,756,507	$ 296,221	$ 224,873	$ 71,348	$ 444,332
13	$ 4,531,634	$ 297,702	$ 229,728	$ 67,975	$ 446,553
14	$ 4,301,906	$ 299,191	$ 234,662	$ 64,529	$ 448,786
15	$ 4,067,244	$ 300,687	$ 239,678	$ 61,009	$ 451,030
16	$ 3,827,566	$ 302,190	$ 244,777	$ 57,413	$ 453,285
17	$ 3,582,790	$ 303,701	$ 249,959	$ 53,742	$ 455,551
18	$ 3,332,831	$ 305,219	$ 255,227	$ 49,992	$ 457,829
19	$ 3,077,604	$ 306,746	$ 260,582	$ 46,164	$ 460,118
20	$ 2,817,022	$ 308,279	$ 266,024	$ 42,255	$ 462,419
21	$ 2,550,998	$ 309,821	$ 271,556	$ 38,265	$ 464,731
22	$ 2,279,442	$ 311,370	$ 277,178	$ 34,192	$ 467,055
23	$ 2,002,264	$ 312,927	$ 282,893	$ 30,034	$ 469,390
24	$ 1,719,371	$ 314,491	$ 288,701	$ 25,791	$ 471,737
25	$ 1,430,671	$ 316,064	$ 294,604	$ 21,460	$ 474,096
Total	**$ 1,136,067** **unpaid balance**	$ 7,311,045	$ 5,663,933	$ 1,647,112	$ 10,966,567

Rather than finishing repayment after 17 years, we estimate that the city could be left with an unreimbursed balance of $1.1 million after 25 years. And, rather than having retained a total of $25 million in Costco sales taxes over 25 years, the city will have retained just $11 million, an average of less than $450,000 per year over the life of the agreement. The agreement we have seen calls for supplemental funds to be applied to this debt as additional projects are initiated in the JDEDZ, but we have seen no accounting or estimate of their value.

Moreover, that doesn't begin to address the real shortfall here, as Section IV reviews the broader impact on the Pleasanton retail market and thus on real sales tax gains due to the JDEDZ.

Staff Statement Regarding NET Sales Tax Revenues

Worth noting here is a meaningful statement contained on page 12 of the City Council Agenda Report for August 29, in which a footnotes states:

> ALH ECON's sales tax estimates take into account leakage from other stores in Pleasanton. In other words, the $926,709 in estimated Sales Tax revenues in the first year of the Costco store being operational on Johnson Dive (sic) would be new revenues to the city.

In fact, the ALH Economic Impact Study forecasts a total of $92.65 million in taxable sales at Costco (yielding the sales tax mentioned above) without regard to market impacts. Indeed, this Agenda Report includes a copy of ALH's Exhibit 57, which estimates **net** sales taxes from Phase I of the EDZ at $841,369.

Regardless, the proposed tax sharing agreement is based upon all taxable sales at Costco without reference to the findings of any market study estimating changes in the local retail market. And, as Civic Economics Section IV discussion demonstrates, ALH has overstated the ability of the Pleasanton retail market to absorb Costco sales without impacting other businesses.

III: OTHER PROJECT FINANCING

In addition to the Sales Tax Sharing Agreement analyzed above, the JDEDZ relies on additional funding sources. Two of those are noteworthy here as they impact the availability of capital improvement funds for transportation projects elsewhere in the city, the Traffic Impact Fee.

Since 1998, the City of Pleasanton has maintained a TIF fund for transportation needs throughout the city. The guiding document for the program was updated in 2010. The proposed funding for the Costco component of the JDEDZ calls on TIF for two distinct pools of money:

1. $6.4 million from existing TIF funds for Stoneridge Drive and I-680 onramp improvements
2. $3.7 million from Costco's project-specific TIF payment

We will briefly discuss each of these sources separately.

Stoneridge Drive and I-680 Onramp Improvements: $6.4 million

The primary access point to the Costco will be on Johnson Drive north from Stoneridge Drive. The project calls for an expansion of a curved portion of Johnson Drive to seven lanes to accommodate customers and suppliers to the Costco site. The alternative for Costco access is a much longer stretch of Johnson Drive to the north and east, using Owens Drive and Clorox Way to access Hopyard Road, a major thoroughfare. To facilitate anticipated Costco traffic from the south, the project calls for widening Stoneridge to feed both the new Johnson Drive lanes and a new second onramp lane to northbound I-680.

The city proposes to fund this improvement (both the Stoneridge widening and the second onramp lane it will feed) using existing TIF funds, generated by other developments through the years. However, the appropriateness of this allocation of TIF money is problematic.

First, the current **Traffic Impact Fee and Nexus Report** (2010, TJKM Transportation Consultants), does not appear to include the Stoneridge onramp in the TIF spending plan. It includes a widening of Stoneridge over I-680 (estimated at $4.65 million in 2010) and a modest reworking of the Stoneridge-Johnson intersection ($0.4 million).

Interestingly, the 1998 iteration of the TIF "Development Fee Project List" did include an estimated $8 million expenditure for I-680 onramps from Stoneridge, but this line item was apparently discarded in the 2010 update.

Second, the current **Capital Improvement Program** for the city (2017/18 – 2020/21) does include a $6.4 million item specifically for the JDEDZ described as "Stoneridge Drive and I-680 Northbound Widening." That project is included in a list and discussion of "City Council CIP Priority Projects." The text there is clear in stating that, "in the event the JDEDZ is not approved the reserve would return to fund balance to be reprogrammed for other General Plan eligible projects." In other words, should the Costco and JDEDZ not go forward, there would be no need for the onramp expansion through at least FY 2020/21.

Civic Economics is in no position to opine on the legality of this proposed expenditure and recommends that interested citizens review the matter with local counsel. However, legality aside, this $6.4 million would be made available for other needed transportation projects throughout the city if the Costco siting didn't require that expenditure to make the JDEDZ site feasible.

Costco TIF Charges: $3.7 million

The second pool of TIF related funds dedicated to the Costco project comes from TIF fees levied on the Costco project itself. Fees on specific projects are governed by legislation and extensive case law; in the present case, Civic Economics accepts the city's assertion that $3.7 million is an appropriate TIF for the Costco project.

According to the city's original technical report on the fee, the purpose of local TIF funds in California is "to assure that all future development contributes its fair share towards the cost of traffic improvements necessary for build-out of the General Plan … [T]he proposed traffic fee will require that each new development pay its fair share through fees needed for City-wide traffic improvements will still requiring that individual development projects construct those improvements which are directly related to their project."

In the present case, Costco will be assessed a TIF in the amount of $3.7 million, but instead of going into the TIF fund to mitigate Costco's share of traffic growth off-site, that money will be spent closer to the site, arguably including improvements that are directly related to the project.

Civic Economics is in no position to opine on the legality of this proposed expenditure and recommends that interested citizens review the matter with local counsel. However, legality aside, this $3.7 million might well be available for other needed transportation projects throughout the city if project-related costs were identified more conservatively or if the Costco were constructed at a site with fewer infrastructure needs.

Combined TIF Diversion: $10.1 million

Combined, these two expenditures of TIF funds, $6.4 million from the existing fund paid into by all the other developments that preceded the Costco and $3.7 million from the Costco project itself, combine to divert millions of dollars from previously transportation improvement projects throughout the City of Pleasanton. Instead, this $10.1 million will be expended in making the JDEDZ site a viable one for the Costco.

IV: IMPACT ON PLEASANTON RETAIL MARKET

This final review seeks to place the proposed JDEDZ retail developments in the context of the Pleasanton retail market. We focus, as above, on the Costco store, as it is the driver of most of retail sales at the site and of the need to invest substantially in transportation infrastructure to serve the site.

The city previously commissioned ALH Urban & Regional Economics prepare an Economic Impact Study of the JDEDZ, which included a market study component. Given the tight time frame of our work, Civic Economics has limited this phase to a review of the ALH study to ascertain whether its methodology and findings are sound with respect to this specific project.

ALH forecasts that Costco and other JDEDZ retailers will not substantially impact other Pleasanton retailers, concluding that the development is almost entirely additive to the local market and thus to municipal sales tax collections. This conclusion leads to the finding that the proposal will not contribute to urban decay, as defined in California law. However, two aspects of that analysis strike us as problematic: (1) It overestimates household consumer demand today and into the future by including irrelevant segments in the analysis and (2) it ignores current retail trends.

Consumer Demand Estimates are Overstated

ALH systematically overestimates household demand for relevant retail goods.

ALH builds its local market analysis on the assumption that Pleasanton residents spend 25% of household income on retail goods, a figure derived from three sources: the Census Bureau's Consumer Expenditure Survey for spending patterns, the California Board of Equalization for sales tax information, and the Association of Bay Area Governments for population forecasts.

The analysis is straightforward and reasonable on the surface. The goal was to estimate the current demand for retail goods impacted by the JDEDZ project, using current household income and retail spending, then carry that estimate into the future to model the local retail economy through the life of the JDEDZ project.

The ALH analysis, though, includes two categories of spending that we contend should have been excluded from the dataset: motor vehicle sales and eating and drinking establishments. Removing those categories reduces the predicted share of household income spent on relevant retail sectors from AHL's 25% to 19.1%. That, in turn, reduces ALH's projected population-driven increase in local retail demand through 2028 from $222.8 million to $172.2 million (Figure 6).

As a result of this overstatement of current and future market demand, the ALH report thus overstates the ability of the Pleasanton retail market to absorb sales from Costco and other retailers in the JDEDZ without harmful impact. Moreover, as discussed below, holding even this lower share of income static ignores recent retail trends, compounding the overstatement through the years.

Figure 6

HOUSEHOLD AND MARKET DEMAND CALCULATIONS

Civic Economics removes vehicle purchases, restaurants and bars from dataset.

Per Household Demand	**ALH**	**Civic Economics**
Motor Vehicle and Parts Dealers	$5,048	$471
Home Furnishings and Appliance Stores	$1,887	$1,930
Building Materials and Garden Equipment Stores	$2,204	$2,254
Food and Beverage Stores	$6,260	$6,403
Gasoline Stations	$4,222	$4,318
Clothing and Clothing Accessories Stores	$2,593	$2,652
General Merchandise Stores	$5,092	$5,208
Food Services and Drinking Places	$4,662	$0
Other Retail Group	$4,590	$4,695
Total	**$36,558**	**$27,930**
HH Demand as a Share of Income	**25%**	**19.1%**
Increase in Households, 2015-2028	**6095**	

Market Area Demand Growth, 2015-2028	**ALH**	**Civic Economics**
Leaving household demand constant as a share of income		
Motor Vehicle and Parts Dealers	$30,770,182	$2,868,045
Home Furnishings and Appliance Stores	$11,500,843	$11,763,232
Building Materials and Garden Equipment Stores	$13,432,983	$13,739,355
Food and Beverage Stores	$38,152,384	$39,023,758
Gasoline Stations	$25,734,700	$26,319,218
Clothing and Clothing Accessories Stores	$15,803,657	$16,164,314
General Merchandise Stores	$31,036,468	$31,742,648
Food Services and Drinking Places	$28,412,138	$0
Other Retail Group	$27,976,200	$28,613,266
Total	**$222,819,555**	**$170,233,835**

Sources: ALH Economic Impact Analysis, Bureau of Economic Analysis

Motor vehicle sales are the most problematic inclusion here. A more typical approach to analyzing retail activity is to separate motor vehicle parts stores, which function like traditional retailers and may be included in the JDEDZ, from those selling vehicles, which do not and will not. In this case, the inclusion of vehicle sales in the analysis also serves to dilute the apparent impact of the JDEDZ retailers. The ALH study counted $5,048 in annual vehicle purchase expenditures as retail; the auto parts retail segment constitutes just $471 of that amount.

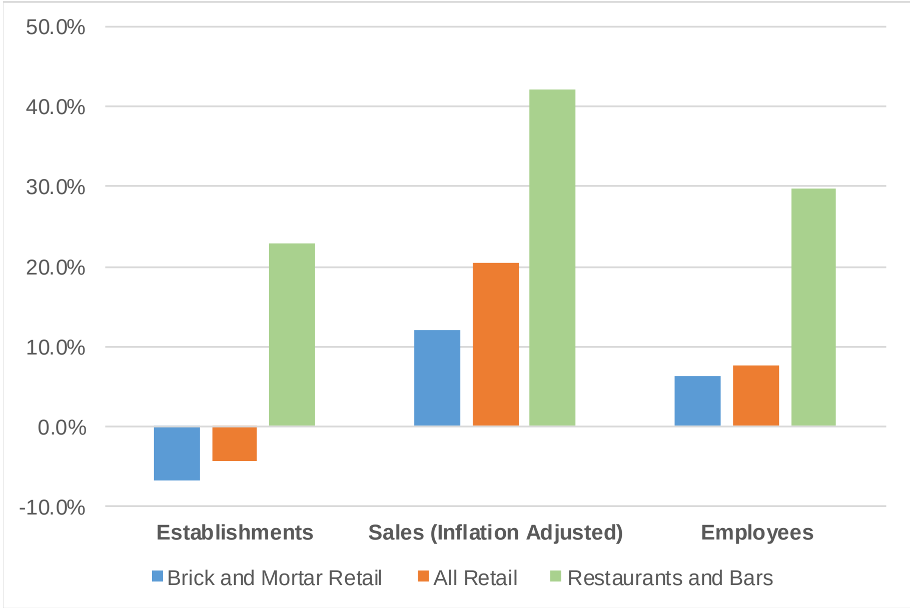
Eating and Drinking Establishments are also included in the retail segment for estimating household consumer demand. Costco stores, of course, include limited on-site food services (estimated by ALH at just $681,000 per year). Including the category in a study of retail again serves to dilute the apparent impact of Costco.

In future years, the JDEDZ is likely to include any number of eating and drinking establishments. This category, however, is generally analyzed separately from conventional retail with very good reason: food and beverage service is a service, not a retail sector, and operates in a market very different from storefront retail.

As depicted in the Figure 7, restaurants have far outperformed retailers in recent years, while brick and mortar retailers have lost ground as a share of overall retail and even relative to population growth. As a result, mixing restaurants and bars into a retail dataset masks negative trends impacting retail stores.

Figure 7

RETAIL vs RESTAURANT MARKET CHANGES, 1997-2012



Source: US Census Bureau, Economic Census

Because the food and beverage sector is growing, it is of little concern that the JDEDZ might introduce additional restaurant locations. And, as with smaller retail locations, restaurants could be developed in the EDZ without the expenditure of millions in infrastructure improvements.

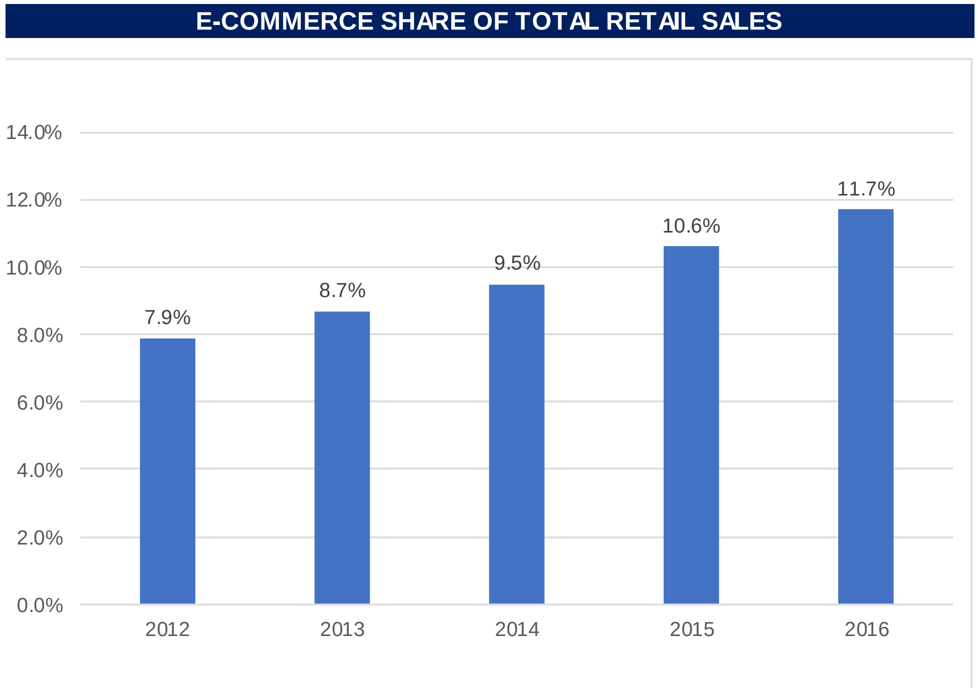
Future Demand Projections Ignore Current Retail Trends

Having established an inflated retail demand estimate of 25% of household income, ALH carries that forward among all new households projected in the market area. Beyond the overstatement of household retail demand demonstrated above, Civic Economics questions the projection that any rate of household retail demand will be flat into the future, at least in regard to storefront retail demand.

The ALH Economic Impact Study makes no reference to the rise of online retailing and its impact on the market for bricks and mortar retailers, ignoring the most discussed and studied aspect of retail economics of the last few years.

Online retail is made up of non-store retailers like Amazon, as well as the online efforts of traditional retailers like Macy's and Home Depot. These sales generate little demand for local retail square footage, which is what the ALH study seeks to forecast. As Figure 8 reveals, forecasts of the market for local storefront retail must account for the ever-increasing diversion of sales from shops to distribution centers.

Figure 8



Source: Internet Retailer analysis of U.S. Commerce Department figures that factors out the sales of goods not normally purchased online such as automobiles, fuel, and sales in restaurants and bars.

This trend shows no sign of abating, and it requires a rethinking of the retail square footage that any given amount of demand will support. While new stores and shopping centers will certainly thrive in the coming years, the quantity and location of those spaces is in flux. Retailers and shopping center developers are acutely aware of this reality, and Pleasanton should be, as well.

Having established that household demand should be based on 19.1% of income rather than 25%, and that holding constant even that lower share demand share is unrealistic, it is clear that a thorough analysis of market demand in Pleasanton might change the finding of the ALH report that Costco and the rest of the JDEDZ retail mix will have negligible impact on the Pleasanton market.

It is worth noting that California does require merchants to collect and remit the municipal share of sales tax for reported online sales to Pleasanton residents, but that still misses a substantial (if currently unknowable) share of sales (made by small merchants either on their own sites or through a marketplace such as Amazon or EBay).

CONCLUSION

Civic Economics was asked to conduct an expedited review of materials produced by and for the City of Pleasanton analyzing the impacts of the proposed JDEDZ. Our work focused on the inclusion of a Costco store because (a) it is the primary driver of sales in the project, (b) its sales is the source of revenues to repay a portion of the infrastructure investment, and (c) its presence is the reason for most of that infrastructure need.

We focused our review on three documents: an economic impact analysis prepared by ALH, a staff memo entitled City Council Agenda Report dated August 29 and prepared by the Community Development Planning Division, and a PDF of a PowerPoint presentation from that same meeting. We also referred to Costco annual reports from 2014 and 2016 and data from the Census Bureau and the Bureau of Economic Analysis.

Much to our surprise, we identified a number of problematic analyses in these reports, which together lead to a substantial overstatement of the benefits and understatement of the costs of the JDEDZ project.

I: Costco Sales Forecasts

> Both city consultants, Century Urban and ALH, overestimate likely Costco sales based on a mix of outdated data and optimistic forecasting.

II: Sales Tax Revenue Sharing Repayment

> As a result, the city's anticipated ability to make planned Sales Tax Sharing payments is in doubt, and its expectation of surplus sales tax revenues is inflated.

III: Other Funding Sources for JDEDZ

> Of the other public funding sources for JDEDZ development, at least $6.4 million and as much as $10.1 million in TIF funding is diverted from other city transportation needs.

IV: Impact on Pleasanton Retail Market

> ALH understates the impact of the JDEDZ on the Pleasanton retail market by (a) overestimating the size and growth of that retail market and (b) ignoring real trends in the retail industry.

In short, the current JDEDZ proposal asks the City of Pleasanton to invest substantial public funds in a costly, long-term, speculative venture in a rapidly changing industry, and to do so based on erroneously optimistic forecasts of costs and benefits. City Council and the citizens of Pleasanton must demand better information before making such a momentous investment.

ABOUT CIVIC ECONOMICS

Civic Economics, established by Matt Cunningham and Dan Houston in 2002, provides a data-driven approach to business and community initiatives with a wide range of goals. We are noted for the innovative application of industry-standard tools and the development of proprietary methodologies that provide credible guidance and evidence to our clients, often addressing novel situations.

Our practice is thematically and geographically broad, but we have developed substantial depth in economic impact analysis, as well as the economics of local and regional retail, land use planning, and gaming.

From offices in Chicago and Tulsa, Civic Economics serves all of North America, from Florida to Alaska and California to Maine, with occasional forays across the border and overseas. We have served some of the wealthiest enclaves in America and some of the poorest, and our clients run from small nonprofits to large corporations and state governments.

Civic Economics provides our clients with credible analyses of current issues, expressed in a clear and concise fashion, to provide relevant information to the public and policymakers. For further information about the firm, its people, and its practice, we invite you to visit CivicEconomics.com.

For more information about this report, please contact:

Dan Houston, Partner
Civic Economics
dhouston@civiceconomics.com
512.853.9044