

**CITY OF SAN DIEGO
M E M O R A N D U M**

DATE: April 15, 2008

TO: Tim Daly, Development Project Manager

FROM: Russ Gibbon, Business Development Manager, Economic Development Division

SUBJECT: Westfield UTC Fiscal, Economic, and Market Studies – EDD Review

Thank you for giving us the opportunity to review and comment on the studies prepared by HR&A Advisors for Westfield Corporation in connection with the latter's proposal to significantly expand and modernize University Towne Center (UTC). Our initial review concludes that the studies were prepared using conventional methodologies and sound analytical approaches. The input data appears to be accurate and reasonable, although we do not necessarily agree with some of the assumptions in the market study which in turn have a significant bearing on the resultant fiscal and economic output data. We generally agree with the conclusions reached by HR&A Advisors, but feel that they generally tend to overstate the public benefits which would result from the project, if it were to be approved and constructed. However, we would also want to make clear, at the outset, that the studies do clearly demonstrate that the project would provide substantial public benefits in terms of net new tax revenues which significantly outweigh the relatively minimal service delivery costs.

The Market Study

Market Areas

The market study is well prepared and utilizes conventional methods to assess the future market demand in the area around UTC and the ability of the expected retail tenants to capture a significant amount of that market share. The center's market is appropriately (in our view) divided into a "Primary Market Area" ("the PMA") and an "Eating and Drinking Market Area" ("the EDMA"). The former is depicted on a map (difficult to discern boundaries) as "Figure 3 – Shopper Goods Primary Market Area" and apparently includes a future projected population of 704,835 people in 2012 and an existing population of 654,474 people spread across 21 zip codes. According to HR&A this market area was delineated by taking into account "*customer patronage information provided by Westfield UTC's on-site manager, the local and regional highway systems, locations of competitive centers and other factors.*" The "Eating and Drinking Market Area" is depicted as a traditional circular area with a radius of three (3) miles from the epicenter which is UTC. The "Eating and Drinking Market Area" is entirely within the City of San Diego, while the PMA includes areas both inside and outside the City.

Competition

The study analyzes UTC's existing and expected future "competitors" as: *Encinitas Ranch Towne Center*, *Mira Mesa Market Center*, *La Jolla Village Square*, and *Fashion Valley*, finding that only the latter contains a tenant mix likely to present serious competition for a modernized UTC. Although it is probably immaterial given the tenant mix, the exclusion of nearby Clairemont Square was surprising. Clairemont Square is also a "power center" with cinemas much like *Mira Mesa Market Center*. Also somewhat disconcerting was the failure to evaluate competition from two other existing regional malls, *North County Fair* in Escondido and *Plaza Camino Real* in Carlsbad. Both are also apparently owned by Westfield, and would be nearly identical to UTC if it is modernized and expanded as proposed. Both are much closer to shoppers in a major part of the delineated PMA - which includes half of Carlsbad, Encinitas, Solana Beach, Rancho Santa Fe, Del Mar, and Mira Mesa. This would suggest that either Westfield accepts the fact that the PMA's of these three malls significantly overlap (ensuring that Westfield faces no competition from other landlords in this geographic area) or that the PMA is overly broad. We are inclined to believe the former. What this means is that, in either case, UTC may not be able to capture all of the market demand projected by HR&A.

Market Input Data

The market study relies on statistical data provided by, among other sources, the U.S. Bureau of Economic Analysis (BEA), the U.S. Census Bureau, California Department of Finance, and Claritas, Inc., a San Diego-based company which HR&A regards as a "nationally-recognized provider of demographic information for market analyses and other purposes." Despite HR&A's regard for Claritas' software products, for income data HR&A chose to rely instead on the more optimistic BEA income data rather than the Claritas' data which they regarded as "conservative" and "unrealistically low." Unfortunately, this study, dated March 2008, probably also did not benefit from more recent national economic data which clearly suggests slower growth, if not an outright recession, a significant tightening in the credit markets, continued stagnation in the housing markets, rising commodity (especially crude oil) prices, a weakening dollar, and higher unemployment – all of which will almost certainly contribute to lower disposable incomes and lower consumer spending in all market areas. Accordingly, if the more conservative Claritas data had been used on the input side of the HR&A study, the output side might have reflected a lower output and less optimistic sales forecasts.

Economic Impacts

HR&A used the **IMPLAN** (**IMP**act Analysis for **PLAN**ning) input-output model to evaluate the potential economic impacts to the San Diego region if the UTC expansion/modernization were to be approved and implemented. This highly-regarded model is probably the most common input-output model used by consulting firms and government agencies to analyze the potential economic impacts of a project or related governmental decision.

The title of chapter III "Economic Impacts in the Los Angeles County Economy" appears to be a mistake. We assume the author intended to write "San Diego County Economy." The results of the economic impact analysis clearly show significant direct and indirect or "induced" economic impacts in terms of employment growth, income growth and overall increased economic activity across a number of sectors and industries. Given the investment proposed - \$683 million in "hard costs" - this is not surprising. The project will undoubtedly have strong, positive economic impacts for the San Diego region.

However, as noted in the section above regarding our analysis of the market study, it is not clear how much of the economic benefits will accrue to the City of San Diego versus other cities in San Diego County. In addition, as we made clear in our 2004 study of the "*Fiscal and Economic Impacts of Large Retail Establishments*," the Economic Development Division heavily discounts the value of economic impacts which are driven by local consumption rather than local production or services provided to outsiders. These "non base sector" jobs and spending in the Construction and Retail Trade Sectors must be traced back to spending and jobs created in base sectors such as manufacturing, tourism, and hosting the U.S. military. In other words, these economic impacts are, for the most part, a *fait accompli*, as they would occur inevitably as a function of the market. Because economic activity generated at the base level always ultimately leads to the demand for new and remodeled retail space (and the resultant construction and other induced economic activity) it is more correct to only emphasize that, because of its location, the City of San Diego should derive a sizable portion of any economic benefits resulting from the project.

Therefore, we conclude that while HR&A's methodology for analyzing economic impacts associated with the construction and use of retail space should be sound, and that they appear to have been calculated correctly, it would be incorrect to dissociate this economic impact analysis from its true market context, or to draw a direct connection between a potential governmental decision, in this case - land use approvals, and the City's receipt of those economic benefits.

Fiscal Impacts

As with their market study and economic impact analysis, HR&A stays on the trodden paths in reconciling the fiscal impacts to the City of San Diego by first calculating the sum total of all General Fund revenue to be derived from the project (both “one-time” and “recurring” revenues) and then subtracting the sum total of the City’s service delivery costs which would result from the approval, construction, and use of the new and modernized retail space. Here again, the fiscal impacts are predicated on a number of assumptions and factors which should be placed into their proper context and more carefully examined.

As stated above, projects which are driven by local demand for goods and services are a function of the market, and in the case of retail sales, the physical location of the retail outlets has the overwhelming bearing on the net fiscal impacts. For a retail project to be truly “revenue positive” to the City it must not shift or “cannibalize” all of its sales (and sales taxes) from other locations, and conversely, it must either prevent “leakage” of consumer spending into other cities’ retail outlets, or capture sales from the residents of other cities. Accordingly, if this is not the case, the fiscal impact analysis is merely identifying a supposedly “new” source of revenues which are, or would be, coming into the City treasury from other outlets. Evaluated from that standpoint, it becomes clear that, in general, retail outlets are always “revenue positive” because the sum total of property, sales, and business license taxes will always exceed the service delivery costs created by the project. A more detailed breakdown of the revenue analysis follows.

One-Time Project Revenues

HR&A states that “The project will generate approximately \$2.2 million in one-time construction related revenues, as shown in Table 6.” Most of this revenue is derived from sales tax on construction materials which, as shown in Appendix C-1, assumes that 50% of the project’s \$683 million in “hard costs” is materials and the other 50% is labor. HR&A also assumes that 50% of the tax will be collected and reported to the City from material vendors and construction companies. Both are reasonable assumptions. However HR&A also “Assumes that construction contractors will take out [a] sub-permit designating the site as a point-of-sale.” Designating the site as a point of sale for the construction contract can be done (voluntarily) by the construction contractor pursuant to the State Board of Equalization’s “Regulation 1806”, but we have found that construction contractors generally do not elect to do so.

Furthermore, the \$2.2 million would only be “generated” by the project if one assumes that the same demand for retail goods would otherwise (“no project alternative”) be met

by retailers located outside the City of San Diego. While the market study did not break out the percentage of the PMA's demand by taxing jurisdiction, it appears that approximately half of the PMA's shoppers are (or will be) San Diego residents who will shop somewhere – most likely near where they live. Therefore the \$2.2 million figure should be netted once again to approximately \$1.1 million at most to make the “will generate” statement more accurate.

Recurring Annual Project Revenues

HR&A states that the project will “generate \$7.3 million per year (discounted to \$3.9 million in constant 2008 dollars) in incremental new revenues. Cumulatively over this period, the Revitalization Project will generate about \$156.6 million (\$84.1 million in constant 2008 dollars) in additional revenue for the City, as shown in Table 7.” Unfortunately, these figures should be further discounted to reflect reasonable assumptions about the origins of the demand, and other factors as well.

Property Tax

HR&A estimates that the project “will yield an annual average of \$1.6 million in additional property tax to the City (\$800,000 in constant 2008 dollars)” This figure includes property tax on the mall itself plus property tax on the 250 proposed residential units which make up about one third of that figure. However that figure should be again discounted by about 50% to account for internal demand which could easily be met by expansions of other malls within the City such as *Fashion Valley*.

Sales Tax

HR&A estimates that the project “will generate an annual average of about \$5.3 million per year to the City (\$2.8 in constant 2008 dollars) in sales tax revenue. As stated in footnote 5 to “Appendix C-2 Sales Tax revenues,” HR&A “Assumes all sales are net new and no sales transfers from existing retailers, including UTC's tenants, based on analysis in separate HR&A market analysis report.” While we agree that the project is likely to capture new demand from the PMA rather than “cannibalize” existing demand from area retailers including those already at UTC, as stated above, it does not necessarily follow that other San Diego retailers would not expand and modernize their malls to meet this demand and capture local sales tax dollars for the City. Using the same discount to reflect sales to existing and projected future San Diego residents, this figure should be adjusted downward by 50% to reflect the demographic distribution of shoppers.

Business License Tax

HR&A estimates that "The City will also collect a modest tax per additional Revitalization Project employee, which is estimated to generate about \$9,300 per year (\$5,200 in constant 2008 dollars)." This figure should similarly be adjusted downward by 50%.

Service Delivery Costs

HR&A uses a "marginal" rather than "average" cost approach to determine the City's service delivery costs for this project proposal. The firm also uses the conventional approach of assessing the cost of adding new employees to San Diego at a rate of one third (.33) of the cost of adding a new resident. We agree that the marginal approach is better suited for a relatively small geographical area which is already highly-developed for the same reasons which HR&A states. Using this approach, HR&A estimates that the City would incur service delivery costs of "about \$700,000 per year." (\$372,000 in constant 2008 dollars). However, we would similarly discount the number of new sales employees from 1,837 to 918 since, as stated above, we would consider these to be jobs (i.e. employees) which would be created anyway within the PMA. Therefore, there would be no service delivery costs associated with these employees. This would result in a 29% reduction (adjustment) of service delivery costs, to \$497,000 (\$264,120 in constant 2008 dollars)

Net Fiscal Impacts (reconciliation)

One-time revenues (related to tax on construction materials)	\$1,100,000
Recurring (Annual) Revenues	
Property Tax	\$ 800,000
Sales Tax	\$ 2,650,000
Business License Tax	\$ 4,650
Total	\$ 3,454,650
Service Delivery Costs (Annual)	\$ (497,000)
Net Annual Fiscal Impact to the City of San Diego:	\$ 2,957,650

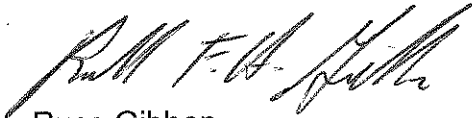
After final reconciliation, it is clear that the project should generate approximately \$3 million dollars annually (nominal dollars) to the City's General Fund if the expansion and modernization of UTC is approved, constructed, and leased out to retailers who are able to achieve the projected sales targets.

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Conclusion

The expansion and modernization of the University Towne Center shopping mall would provide the City of San Diego with extraordinary public benefits mostly in the form of approximately \$3 million in net new annual General Fund tax revenues. The actual construction process should generate an additional approximately \$1 million in General Fund revenues, and the economic activity associated with the project will also provide benefits to the City in the form of job opportunities for its residents.

Please feel free to contact me with any questions. (619) 236-6360



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