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Memorandum

To: Nicholas Liguori, Director of Development Services, City of Chino
CC: Warren Morelion, City Planner, City of Chino

From: Bravish Mallavarapu, Director, Stanley R. Hoffman Associates, Inc.

Date: January 15, 2021

Subject: SOI Fiscal Impacts Sensitivity Analysis Based on 2020-21 Factors

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The technical analysis being presented at the Chino Sphere of Influence (SOI) Annexation Workshop, scheduled for January 27, 2021, includes the comprehensive fiscal impact analysis report finalized in July 2019. The fiscal impact analysis examines the public revenue and cost impacts for ongoing operations and maintenance on the City's General Fund associated with the various annexation scenarios. Given the time elapsed since the original study, the planning team (city staff and the lead consultant Stanley R. Hoffman Associates, Inc.) has conducted **a limited sensitivity test of key assumptions and inputs reflecting current conditions on the original fiscal impact outcomes**.

In this memorandum, we are presenting the findings of this sensitivity analysis based on current 2020-21 key fiscal and market condition factors that constitute the main drivers of the SOI impact analysis. Short of another comprehensive study, this focused approach is well-suited to determine any significant deviations from the original findings.

Our analysis indicates that the overall fiscal results for the annexation scenarios, testing for current market conditions, remain consistent with the original findings. At the same time, it is noted that due to the unusual pandemic-impacted 2020-21 fiscal period, the increase in public costs is slightly higher compared to the increase in public revenues, and thus the net impacts are skewed slightly toward the costs side for the scenarios where new service population is large (i.e. the two complete SOI annexation scenarios).

The City currently benefits from a mix of positive sub-regional economic and market trends (including a boom in the logistics sector/associated employment, housing demand and home price increases), while also facing headwinds from uncertainties associated with a slow post-pandemic correction. It is likely that the 2020-21 cost-revenue relationships are specific to this current unusual period, and will revert to the long-term average growth trends assumed in the original 2019 fiscal study.

Fiscal Impacts Sensitivity Methodology

This sensitivity analysis adjusts the following assumptions and inputs reflecting the current fiscal year 2020-21 conditions to test impacts on the fiscal outcomes for the four SOI annexation scenarios:

- General city assumptions, including 2020 population, employment and service population estimates;
- Public expenditure factors adjusted based on the City's 2020-21 Adopted Budget;
- Public revenue factors based on the City's 2020-21 Adopted Budget;

- Adjustments made to residential and non-residential property valuation price assumptions reflecting current home prices, and office, industrial and retail valuation per square foot trends;
- Adjustment to retail sales performance factors based on the regional urban consumer-price index.

SOI Annexation and Property Tax Sharing Scenarios

As documented in detail in the original 2019 study, the sensitivity evaluation in this memo is presented for four annexation scenarios, each including four fiscal policy assumptions on the allocation of property tax and the property tax in-lieu of the motor vehicle license fee (VLF) accruing to the City General Fund from the annexation areas. These are described in Appendix A.

Sensitivity Analysis Results at Build-Out

The fiscal impact sensitivity evaluation at build-out, as organized below by the four annexation scenarios and summarized in **Figure 1**, **shows the net impact on the General Fund** (i.e. revenues minus costs) :

General Plan Scenario: The results from the 2019 Study (2018-19 factors) and the 2020 Test (2020-21 factors) are broadly similar. As indicated before, the 2020 test analysis is skewed slightly toward higher public costs arising from the large increase in service population under complete SOI annexation, which impacts the net positive outcome for the marginal case ALT 3 from the 2019 study.

Figure 1
General Fund Fiscal Impact Sensitivity Evaluations by Scenarios at Build-Out

Source: Stanley R. Hoffman Associates, Inc.

Market Trends Scenario: The results from the 2019 Study (2018-19 factors) and the 2020 Test (2020-21 factors) again are similar for this scenario. However, the higher public costs due to the large increase in service population upon complete SOI annexation under this scenario are mitigated by the higher market-based development valuations compared to the General Plan scenario. These conditions contribute to higher levels of property and sales taxes accruing to the General Fund. At the same time the higher public costs impact the net outcome for the marginal positive case ALT 2 from the 2019 study.

Island Only Scenario: The results from the 2019 Study (2018-19 factors) and the 2020 Test (2020-21 factors) are again similar. In contrast to the preceding complete annexation scenarios, the Island Only scenario has significantly lower service population, and therefore, comparatively lower service costs.

Status Quo: The fiscal impact for this scenario from the 2019 Study (2018-19 factors) and the 2020 Test (2020-21 factors) remain positive similar to the Island Only case. In contrast to the complete annexation scenarios, the Status Quo scenario has significantly lower service population, and therefore, lower relative costs. Development growth under this scenario is assumed at the historical pace of annexations.

2020-21 Fiscal and Market Test Assumptions

The following adjustments were made to the fiscal and market factors for the sensitivity evaluation:

General Assumptions

As shown in **Appendix Table B-1**, population was revised-up to the 2020 Department of Finance (DOF) estimate of 89,109, including 83,567 household population, 2,5002 occupied housing units for a household size of 3.47. Current employment is estimated at 52,000 jobs based on more recently published data. The combination of residential population and employment numbers result in a day-time service population of 113,029 persons.

Market Factors

New Residential Valuation: Based on a market trends review, year-over-year (Nov 2019 to 2020) home price increases for the City of Chino sub-region varies across multiple data sources, and is estimated to be around 15 percent increase for a typical home. As shown in **Appendix Table B-1**, we have assumed a slightly conservative number of 13 percent increase over this time period for the fiscal impact test, which results in a moderated increase in property-related revenues starting in the base year.

New Non-Residential Valuation: Based on a market assessment of year-over-year (Nov 2019 to 2020) valuation per square foot price changes for the City of Chino sub-region and the Inland Empire, we have assumed a 10 percent increase for the office, retail and industrial non-residential valuation factors starting in the base year, as shown in **Appendix Table B-1**.

Existing Base Year Valuation: The underlying property valuation for the SOI following a detailed parcel level calculation in 2019 has been increased by a conservative 2 percent rate for 2020.

Retail Sales Performance: This factor was increased by 1.9 percent for the Nov 2019 to 2020 period based on the urban consumer price index (CPI) estimate for the Riverside-San Bernardino metro area published by the Bureau of Labor Statistics (BLS), **Appendix Table B-1.**

Public Revenue and Cost Factors

Public costs and revenue factors were updated to reflect the 2020-21 Adopted Budget. These details are shown in **Appendix Table B-2**.

Conclusions

1. Our analysis from this sensitivity evaluation of 2020-21 factors indicates that the overall fiscal results for the annexation scenarios, testing for current market conditions, remain consistent with the original findings of the 2019 comprehensive study.

2. It is noted that the increase in General Fund public costs are slightly higher relative to the increase in public revenues testing the 2020-21 fiscal and market factors when compared to the 2019 comprehensive study. This impacts two marginally net positive cases from the 2019 fiscal study.

3. In particular, police protection costs, which form nearly two-thirds of all General Fund expenditures across all planning scenarios presented here, increased by about 9 percent from $355 to $386 per capita service population. This might be attributed to the current pandemic conditions, and possibly specific to this short-term period.

4. The current sensitivity evaluation continues to underscore the critical significance of the City's General Fund receiving the full 10.8 percent share of the one percent property tax levied on future valuation from the SOI areas. This policy issue should be taken up in earnest with LAFCO pursuant of decisions to annex the SOI areas.

APPENDIX A

ANNEXATION DEVELOPMENT SCENARIOS

Scenario	Description
GENERAL PLAN	This scenario is based on a capacity analysis of the **current General Plan zoning conditions** and assumes that **projected growth will not exceed any of the zoning** capacities of the City's General Plan for the SOI areas.
MARKET TREND	This development scenario is based on an assessment of **market demand and residential product types at different density levels that can exceed zoning** capacities of the City's General Plan for the SOI areas.
ISLANDS ONLY	This scenario assumes that **vacant and underutilized parcels within identified islands** will develop because they are located relatively near to existing services.
STATUS QUO	Annexation would **continue as it is currently processed**. Any new annexation will need to connect to the City's sewer system.

FISCAL POLICY ALTERNATIVES

Alternative	Property Tax Rate of 1% Levy	Property Tax In-Lieu of VLF
BASE CASE	SOI = 5.4 % Islands = 10.8%	Valuation Increase Only
ALTERNATIVE 1	SOI = 10.8 % Islands = 10.8%	Valuation Increase Only
ALTERNATIVE 2	SOI = 5.4 % Islands = 10.8%	Base Value + Valuation Increase
ALTERNATIVE 3	SOI = 10.8 % Islands = 10.8%	Base Value + Valuation Increase

APPENDIX B
FISCAL STUDY ASSUMPTIONS

Appendix Table B-1
General and Market Assumptions

	2019 Fiscal Report	2020 Sensitivity Test	
General Assumptions			
Population	89,829	89,109	
Household Population	84,122	83,676	
Households	25,002	24,152	
Household Size	3.37	3.47	
Employment	45,127	52,000	
Service Population	110,588	113,029	
Market Factors			**% Increase**
Residential Valution per Dwelling Unit			
RD 1	$1,095,626	$1,238,057	13.0%
RD 2	$952,718	$1,076,571	13.0%
RD 4.5	$889,530	$1,005,169	13.0%
RD 8	$681,819	$770,455	13.0%
RD 12	$407,993	$461,032	13.0%
RD 20	$346,794	$391,878	13.0%
RD-MU (20 du/ac)	$346,794	$391,878	13.0%
Non-Residential Valution per Square Foot (Sq.Ft.)			
Retail	$219	$241	10.0%
Office	$161	$177	10.0%
Industrial	$102	$112	10.0%
Retail Sales per Sq.Ft.	$230.0	$234.4	1.9%

Source: Stanley R. Hoffman Associates, Inc.

Appendix Table B-2
City Budget Fiscal Assumptions

	2019 Fiscal Report	2020 Sensitivity Test	Basis
REVENUE FACTORS			
Property Tax	5.4%	5.4%	City General Fund share of 1% levy for areas outside islands
	10.8%	10.8%	City General Fund share of 1% levy for island areas
VLF - Property Tax In Lieu	$750	$750	per $1,000,000 assessed valuation
Franchise Fees	$28.29	$26.50	per service population
Sales and Use Tax	1%	1%	of taxable sales
	12.3%	12.3%	of sales tax
Real Property Transfer Tax	4.0%	4.0%	turnover rate
	$0.55	$0.55	per $1,000
Licenses, Permits, Fines and Fees	$16.15	$17.62	per service population
Intergovernmental Revenue	$0.56	$0.00	per capita
Charges for Services	$2.44	$2.90	per service population
Other Revenue	$0.29	$0.31	per capita
Transfers to General Fund	$63.65	$72.38	per service population
Interest Earnings	1.4%	1.2%	of projected recurring revenues
COST FACTORS			
General Government	6.7%	6.7%	of direct department costs, at a 75% marginal rate
Fire Service Contract	0.38%	0.38%	City General Fund share of 1% levy, North SOI
	0.31%	0.31%	City General Fund share of 1% levy, South SOI
Police Protection	$354.60	$385.55	per service population
Development Services	$17.02	$7.69	per service population
Transfers to Other Funds			
Community Services Fund	$55.95	$64.17	per capita
Transportation Fund	$37.19	$61.83	per service population
Landscape and Lighting Fund	$43.56	$50.68	per service population
City's Portion for 50% Perimeter Fair Share	$0.00	$5.69	per service population
Assessment District Backfill	$2.26	$3.19	per service population
Total Transfers to Other Funds	$138.96	$185.56	per service population

Sources: Stanley R. Hoffman Associates, Inc.
City of Chino*, Fiscal Year 2018-19 and 2020-21 Budgets.*

APPENDIX C
BACKGROUND MARKET TRENDS

Employment Trends

The impact of the pandemic has varied across market areas and industry sectors. Based on data published by the California Employment Development Department (EDD), the number of jobs in the Inland Empire (Riverside-San Bernardino MSA) declined 12.5 percent over a single month between April and May of 2020, translating to a loss of nearly 192,000 jobs. In comparison, the Los Angeles-Long Beach-Anaheim MSA experienced a steeper decrease of 14.3 percent over this period.

However, the latest monthly jobs bulletin released by the EDD in December 2020 indicates a steady ongoing recovery for the Inland Empire. The MSA experienced a net 1.2 percent gain of 17,200 non-farm jobs between October and November 2020, and additionally is estimated to have recovered around 95,000 non-farm jobs (7.1 percent increase) since the lowest point in May 2020.

Transportation and warehousing is one of the bright spots for the Inland Empire economy in this ongoing recovery. Employment in this industry grouping increased by 3.2 percent since November 2019 (contrasted to an overall decline), and more recently, an increase of 6.1 percent since October 2020, constituting half of all non-farm job gains within the MSA over the Oct-Nov 2020 time period. Other notable employment increases over this recent period include professional and business services (1.3 percent) and retail trade (3.6 percent).

Employment estimates at the city level are not readily available for this most recent period. For this fiscal sensitivity evaluation, Chino is estimated to have 52,000 total jobs by year-end 2020. These numbers have been developed by comparing available data sources. SCAG estimates from the Adopted 2020 Regional Transportation Plan (RTP) show employment numbers increasing from 50,400 in 2016 to 57,400 in 2045. In comparison, data provider Chmura Economics has estimated 51,224 jobs in Chino for 2019Q4. The Chmura numbers do not include estimates of self-employment, which typically constitute 10 percent of total jobs. Adjusting these numbers for self-employment, the total jobs for 2019Q4 are estimated at about 57,000. However, both the SCAG and Chmura numbers do not reflect the recent downturn. Applying a 7 percent year-over-year regional employment decline since Nov 2019 results in about 53,000 jobs for Nov 2020. We have assumed a slightly more conservative estimate of 52,000 jobs for Chino for this fiscal analysis, where employment numbers are used to calculate the daytime service population for cost and revenue factors.

Residential Valuation

The Inland Empire continues to experience a surprising uptick in housing demand over this pandemic period. This is attributed evidently to households moving out from the Southern California urban core in search of more space and fewer crowds. Jobs growth in the transportation and warehousing sector is also cited as a pull factor toward IE cities. Additionally, these choices are being supported by historically low interest rates that have buoyed housing demand. As a result, home prices have experienced healthy increases over the last year in the region. Given the difficulties for households, especially younger families, to make frequent moves, it is likely that new arrivals to IE cities will remain anchored over the medium-term. This in our opinion has raised the overall valuation floor of the housing market in IE cities for year-end 2020 compared to 2019. The IE cities are currently experiencing a tight housing market with decreasing inventory levels, as active listings cannot keep up with pent up demand, according to the California Realtors Association.

For this fiscal sensitivity evaluation, reflecting 2020-21 conditions, we have assumed a 13 percent upward shift in the price floor across the residential product types analyzed for the new SOI development at buildout. We are making the case that the medium-term stability from new homeowners will likely create an enabling environment for residential development over the long-term. This overall valuation floor increase has been estimated by comparing several data sources. Given issues related to location specific sample size, price increases for individual product types is not readily available at this moment given the recentness of events. However, looking at a 'typical home', the California Realtors Association shows a 17 percent year-over-year increase in home prices since November 2019 for the Inland Empire. In comparison, the real estate data provider Zillow, in its Zillow Home Value Index (ZHVI) database, indicates a 9 percent increase in "typical" medium-tier home values for the Inland Empire and Chino City. Zillow also publishes the Zillow Home Value Forecast (ZHVF) that forecasts price increases for medium-tier homes for the next year. This index shows an annual increase up to November 2021 of 10.3 percent for Chino and around 10.5 percent for IE.

<u>Non-Residential Valuation</u>

Non-residential valuation price factor adjustment for this fiscal sensitivity evaluation for new SOI development at build-out reflect current market conditions. Factors have been updated based on an understanding that new projects will need to clear current market prices in order meet expectations on returns on investment. Looking at information from data provider CoStar, valuation price per square foot for office, industrial and retail have all gone up since year-end 2018 in the broader Inland Empire when the original market price factors were developed. This is attributed again to the continuing strength of the logistics sector and support office services, and an increase in household consumer spending.

For year-end 2020, Costar currently shows industrial average price per square foot for the Inland Empire at $137.06 compared to $127.82 for year-end 2018 for all industrial properties or an increase of about 7 precent. For logistics, price per square foot increased from $128.43 by year-end 2018 to $143.11 for year-end 2020, an increase of about 12 percent. We have assumed an average 10 percent increase to the industrial price floor for this fiscal sensitivity update, arriving at $112 per square foot.

For office valuation, CoStar shows average price per square foot at $181.41 across all office property classes for year-end 2020 compared to $176.39 for year-end 2018 or increase of about 7 percent over this period. Four and Five star property prices increased from $215 by year-end 2018 to $315 by year-end 2020, representing a steep 45 percent increase. Three star buildings valuation per square foot increased by 8 percent over this period, while 1-2 star buildings went up by 17 percent. We have again assumed an average price floor level increase of 10 percent reflecting current market conditions for this current sensitivity evaluation arriving at $177 per square foot.

For retail valuation, CoStar shows average price per square foot at $233.96 across all retail property classes for year-end 2020 compared to $202.69 for year-end 2018 or increase of about 15 percent over this period. Neighborhood Center prices increased from $191.30 by year-end 2018 to $228.68 by year-end 2020, representing a 19 percent increase. The average price per square foot for Power Centers reached $261.8 by year-end 2020 compared to $154 for year-end 2018. General retail property valuation per square foot increased by 8 percent over this period. We have again assumed an average price floor level increase of 10 percent reflecting current market conditions for this sensitivity evaluation arriving at $241 per square foot.