Marin Economic Consulting

Date: December 8, 2014

To: Angela Calvillo, Clerk of the SF Board of Supervisors

From: Jon Haveman, Principal

RE: OCII Supplemental Appeal Response – Corrections to Fiscal Impact Rebuttal

Hearing Date: December 8, 2015

This document responds to OCII concerns regarding and misunderstanding of the basic economics behind the Marin Economic Consulting (MEC) report: *Warriors Stadium Economics: Uncertainty and Alternatives*, Version 2.0, November 29, 2015.

The OCII "Supplemental Appeals Response"[1] on pages 14-17 provides a response to elements of the MEC report. These responses are outlined below, with an explanation for why they are invalid or trivial criticisms of the report. As will become clear, issues such as these, which are extremely complicated, require very careful analysis and very careful use of the models involved.

Issues and MEC response in order of occurrence in the OCII document:

1. ***Excluding the Transient Occupancy Taxes from the analysis.***
    a. This is not only the position of MEC, but is the position recommended by the City's own Budget and Legislative Analyst.
    b. OCII asserts that because I have included these revenues in past reports, they should be included in this report.
        i. This represents a fundamental misunderstanding of the appropriate uses of Economic Impact Analysis.
            1. There is a significant difference in the treatment of one-time events and ongoing events. Revenues from one-time events are much more likely to represent additions to the economy than are ongoing events.
                a. The America's Cup events were one-time events. The GWS project is ongoing.

[1] "Appeal of Certification of Final Subsequent Environmental Impact Report, Event Center and Mixed Use Development at Mission Bay Blocks 29-32, Supplemental Appeal Response", December 7, 2015.

[2] http://www.sf-planning.org/ftp/files/legislative_changes/new_code_summaries/120523_TIDF_Tra

b. On these grounds alone, it is not appropriate to include the TOT in estimates of increased revenues. Their inclusion is likely to overstate the benefits of the project.

ii. There is scant *reputable* economic analysis that supports the notion of external benefits to the economy due to the construction of a sports arena. That is, the reputable evidence indicates that there is no long-term boost to the economy associated with the construction of a sports arena.

1. Accordingly, these external benefits, such as taxes from hotel stays, are not appropriately included in an analysis of the GSW arena construction.

    a. Whereas they may be appropriate to consider in another context. A context associated with an economic activity that generates a tangible economic product or service, for instance.

2. Over the long term, especially in a City such as San Francisco, where hotels are generally at capacity, additional demand for hotels either:

    a. Crowds out existing hotel stays, resulting in no net new tax receipts, or

    b. Results in the construction of new hotels, which crowds out other economic activity, especially in a City such as San Francisco, which is land constrained.

3. The inclusion of external benefits could be argued in the absence of evidence to the contrary, which exists in abundance.

iii. It is a fundamentally difficult task to estimate these hotel revenues.

1. Counting simply the spectators that stay at hotels likely overstates net new hotel stays for the following reasons:

    a. Some (most?) would have stayed in SF hotels if the Warriors continued to play in Oakland. There is to our knowledge no evidence on this point.

    b. There would likely be a crowding out of other hotel guests, resulting in a reduction of net new TOT revenues.

2. While (a) can be estimated, (b) can not. Hence, any evaluation of additional hotel stays will almost necessarily overstate reality.

iv. The figures used by City to estimate net new Transient Occupancy Taxes is not rooted in sound science. It is "10% of event attendees are potential overnight visitors and, of that potential, only 50% generate hotel demand that is included in the study."

1. It is reasonably clear that these numbers, 10% and 50%, are simply guesses.
2. The use of the $1.7 million number clearly makes the arena look like a better investment, but it is not rooted in reality and – in the absence of estimates based on evidence - should be excluded from the analysis.

v. The EPS analysis has rightly excluded the additional demand generated by the office and retail tenants, as has the MEC analysis.

1. This represents tacit agreement on the part of EPS that external, or secondary benefits should *not be included*.

vi. It is also the case that the inclusion of secondary benefits in estimating the City's financial obligations going forward is not sound. (This is the contention expressed in the MEC report and in the Budget and Legislative Analysts report, November 6, 2015.)

1. It is not sound because they are extremely difficult to estimate.
2. It is not sound because it explicitly increases the size of the *subsidy* to arena operations by the City.

vii. Finally, there is an important distinction to be made between economic activity that is attributable to a project and the net increase in economic activity (or revenues) that are attributable to an activity.

1. The reports indicated by OCII are calculations of economic activity *attributable to* the project in question and not the net increase in economic activity.
2. Given that government subsidies, in the way of payment of transit expenses, (should) hinge on the calculation of the net increase in revenues associated with the event, including a dubious calculation of a single secondary benefit is not a sound practice. In this case, it leads to excessive subsidization by taxpayers of an extremely profitable private activity.

2. **OCII indicates that "it is hard to imagine a scenario where an established NBA franchise would not seek to recover its estimated $1.4 billion upfront investment by seeking to boost attendance and thereby fail to generate even 20 percent of anticipated City revenues."**
    a. This quote is referring to the ability of the revenues to cover the debt servicing of $2.1 million per year.
    b. What they say is true, but is irrelevant, because in a bad year, the $2.1 would come out of the 10% buffer that the City will keep, after paying for transit expenses. (According to a conversation with the Budget Analyst.)
    c. The statement is especially true given the massive subsidy that the City is giving to arena operations. (Approximately, $10 million per year.) With such a subsidy, the GSW will pursue events at the arena that they otherwise would not (simple economics: if you subsidize an economic activity, you will get more of it).
        i. Were GSW responsible for all of the additional transit costs and not receiving the subsidy, there would be fewer events, lower costs, and less congestion.
3. **The OCII document makes much of the fact that the MEC study excludes an estimated $2.6 million in dedicated and restricted funds for voter mandated set-asides. "OCII disagrees that they should be excluded from the calculation of public benefit to the City."**
    a. The MEC report does not disagree with this. The MEC report is limited to a discussion of the impact on the City's **General Fund**.
    b. At the same time, these additional revenues do nothing to insulate tax-payers from having to make additional contributions to GWS related expenses.
        i. Should 90% of revenues fall short of transit related expenses, the General Fund will still have to use its 10% surplus (as indicated in the City ordinance establishing the transit fund), to cover non-transit related expenses, including debt servicing ($2.1 million), police, and DPW. Per a conversation with the City Budget Analyst.

4. **OCII takes issue with a miscalculation of Transit Impact Development Fees (TIDF) in the MEC report.**
    a. Accepting that the sales price was $155.1 million and there was an additional related purchase across the street of parking in the amount of $5 million, the TIDF should be estimated at $3.9 million, 7% less than the original amount resulting from the $172 million purchase price (not 5% less as in the OCII document – it is inappropriate math to round something up and then claim it to be a smaller percentage. Percentages should be calculated prior to rounding.)
        i. This is a quibble over $243,400, which is truly inconsequential to any of the conclusions that might be reached in any analysis of this project.
5. **The MEC report expresses concern over a last minute concession to GSW in terms of the Stadium Admissions Tax. OCII indicates that this notion is purely speculative.**
    a. True, it is speculative, but based in reality. The Giants currently enjoy very low Stadium Admissions Taxes, as a special exemption.
    b. Should a reduction in the tax be granted, this alone could eliminate any surplus in the General Fund.
6. **OCII takes issue with the MEC assertion that there is "razor thin margin for benefit". They neglect to mention that the MEC report is referring to the General Fund.**
    a. The estimated surplus in the General Fund is $1.5 million, according to the Budget Analyst. With a project as large as this, and as heavily dependent on spectators, this in MEC's view, is a razor thin margin for the General Fund.
    b. Again, the OCII confuses conclusions in the MEC report which refer to the General Fund with conclusions that might result from an assessment of public benefit. See below for an appropriate analysis of public benefit, which necessarily includes an evaluation of alternatives.
7. **OCII claims that should costs exceed revenues in any given year, responsibility for maintaining a set of quantifiable and enforceable performance standards [...] will transfer to the project sponsor.**
    a. There is some concern regarding the enforceability of the Mitigation Measures indicated.
    b. Regardless, this transfer of responsibility does not, as mentioned above, apply to up to $3,000,000 in debt servicing, police, or DPW expenses.
        i. The Taxpayers will be on the hook for these additional expenses.

8. **The OCII document claims that the proposed alternative development is infeasible because of building size constraints.**
    a. If the MEC estimates are based on a building that is too large, and if instead the calculations included buildings as proposed originally by Salesforce, as OCII suggests:
        i. There would be 22,000 fewer square feet of commercial
        ii. There would be 82,500 fewer square feet of retail
        iii. The fiscal impact of this change is:
            1. $2 million in one-time revenues
            2. $600,000 in ongoing revenues
        iv. Over a 20 year time frame, this implies:
            1. A decline in present discounted revenues associated with the alternative project of $9.6 million.
    b. These changes are of little consequence to the overall evaluation of the GSW project versus an alternative.
        i. There remains a difference over 20 years of between $71 million and $150 million in General Fund revenues.
9. **OCII takes exception to the employment calculation in the MEC report.**
    a. OCII may be correct that MEC has overstated the employment difference.
    b. At the same time, it must be recognized that:
        i. it is highly likely that there will be more employment at a commercial enterprise than in a stadium that only functions part time
        ii. not only does the number of FTE jobs differ, but the nature of the jobs and the overall contribution to the economy is considerably different.
    c. Failure to recognize these differences is to inappropriately evaluate the merits of the project.

10. **OCII indicates that the MEC report does not allocate ongoing funds for transit costs related to the alternative project.**
    a. The MEC report understates the amount of the TIDF slightly (see above) and attributes the entire amount to transit capital improvements.
        i. Some portion should be allocated to annual costs. From the description of the TIDF:
            1. "The Transit Impact Development Fee (TIDF) is an impact fee levied on most non- residential new development citywide to offset new development's impacts on the transit system. Revenue generated by the fee is directed to the San Francisco Municipal Transportation Agency (SFMTA) and is used to fund Muni capital and ***operations***." [2] (bold and italics added)
        ii. That some portion was not allocated to annual costs in no way changes the results of the analysis.
    b. The MEC report does not understate the expected costs of transit capital and operations as OCII would have you believe.
        i. The expected costs of transit capital and operations is proxied by the TIDF, which applies to representative projects, which the alternative project **IS**, and the GSW project clearly is not.
    c. That OCII would highlight this as a criticism of the MEC report is either an attempt to overstate the perceived flaws in the MEC report, or is a misunderstanding of the TIDF on their part.

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[2] http://www.sf-planning.org/ftp/files/legislative_changes/new_code_summaries/120523_TIDF_Transportation_Impact_Development_Fee_Update.pdf, New Planning Code Transit Impact Development Fee Update, San Francisco Planning Department.

Summary

This document attempts to address the City's response to the MEC report "Warriors Stadium Economics: Uncertainty and Alternatives". The report is a sincere effort to inform decision-makers about exactly what is being given up in terms of General Fund revenues over the first 20 years of active use of the Event Center.

The report indicates that this cost is as follows:

- Between \$3.6 million and \$7.4 million per year, or
- Between \$80.2 million and \$163 million over 20 years.

Taking into consideration, but not necessarily agreeing with the concerns expressed in the OCII report does not change the results significantly. Revised results are:

- Between \$3.2 million and \$5.3 million per year, or
- Between \$70.9 million and \$116 million over 20 years.

Although these revised figures are lower, they remain significant. The reality is that pursuing the GSW brings with it some very significant opportunity costs. Much is being given up to host the Warriors.

Additional Notes:

1. Eliminating or reducing the transit subsidies would do a great deal to reverse this outcome.

2. If the time horizon were increased to 30 years, the General Fund revenue gap would widen by an additional \$23.6 million.

3. At the same time that this analysis applies to the General Fund, the first version of this report applied to the overall fiscal picture. There, it was also clear that the difference in overall revenues from the GSW were less than those associated with an alternative project, but a wide margin.

4. Even if the revenues associated with a project cover the City's costs associated with the project, that does not mean that the project makes sense. It merely means it is more likely to fail a cost benefit analysis than were the net revenues to be positive. An analysis that would necessarily consider alternatives.