SARATOGA CITY COUNCIL

MEETING DATE: March 16, 2005 **AGENDA ITEM:** 9

ORIGINATING DEPT.: City Manager's Office **CITY MANAGER:**

PREPARED BY: Lorie Tinfow, Asst. City Manager **DEPT. HEAD:** Lorie Tinfow

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SUBJECT: Redevelopment Feasibility Study Determination

RECOMMENDED ACTION:

Accept the final report prepared by the Rosenow Spevak Group (RSG) and the study's conclusion that Redevelopment is not a viable option for the City of Saratoga.

REPORT SUMMARY:

Feasibility Study Initiated

At the March 3, 2004, Council meeting, Council authorized staff to explore the feasibility of establishing a Redevelopment Agency in Saratoga. A Request for Proposals document for a Redevelopment Feasibility Study was created and distributed, and responders were interviewed. Rosenow Spevak Group (RSG) was selected by the Village Ad Hoc Committee to perform the study in part because their proposal was particularly cost effective—$26,000 for the study weighed against the potential for millions of property tax dollars to be returned to Saratoga over the next 40+ years instead of added to State coffers.

A thorough study of redevelopment requires legal counsel and last fall, the City Attorney and I interviewed and retained legal counsel Jerry Ramiza from McDonough Holland and Allen. He provided advice on the consultant's draft report and contributed to the Village Ad Hoc Committee's deliberations about whether or not to proceed with the process.

The study concluded that two of the three designated areas—the Gateway area (Saratoga-Sunnyvale Road from the railroad tracks to Prospect) and the Quito area—"lacked any significant conditions of blight." The focus of the study rests on the Village area.

Conditions of Blight

Many cities throughout California have established Redevelopment Agencies. The vast majority of agencies were established before 1993 when the conditions required to designate an area for redevelopment were very different from those now in place. The definition of blight was so vague that it allowed project areas to be characterized as blighted without the presence of substantial physical deterioration. AB1290 was adopted by the Legislature in 1993 and changed that definition. Now, conditions of both physical and economic blight must be found and "must be so prevalent and substantial to cause a reduction of, or lack of, proper utilization of the area to the extent that it constitutes a serious physical and economic burden to the community."[1]

After conducting a field survey and research of the Village area, RSG concluded that the area has one physical blighting condition—"factors that hinder economically viable use or capacity of building or lots"—but this condition cannot be deemed to be pervasive to pose a serious burden on the Community. No economic blight conditions were found.

Conclusion

Both the consultant and the redevelopment attorney counseled the Village Ad Hoc Committee that moving forward with redevelopment would be "politically and legally challenging." The Committee reluctantly accepted the conclusion.

A copy of the final study is attached.

FISCAL IMPACTS:

If redevelopment activities are concluded, no additional fiscal impacts exist.

ADVERTISING, NOTICING, AND PUBLIC CONTACT:

Nothing additional.

CONSEQUENCES OF NOT ACTING ON RECOMMENDED MOTION:

N/A

ALTERNATIVE ACTION(S):

None.

FOLLOW UP ACTION(S):

Staff will convey Council's direction to the consultant and attorney, and conclude our agreements with them.

ATTACHMENTS:

- Rosenow Spevack Group Redevelopment Feasibility Study

[1] Taken from page 4 of the Feasibility Study.

RSG
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February 17, 2005

Via E-Mail

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REDEVELOPMENT FEASIBILITY STUDY FINDINGS

Dear Mr. Ramiza:

The Economic Development Department of the City of Saratoga ("City") retained Rosenow Spevacek Group, Inc. ("RSG") to study the feasibility of establishing up to three redevelopment project areas for the Saratoga Redevelopment Feasibility. These project areas have been identified as: Village Area, Gateway Area, and the Quito Area, as depicted on the maps attached.

Upon a cursory review of the conditions of the Gateway and Quito Areas, RSG concluded that these areas lacked any significant conditions of blight as they were largely vibrant commercial and residential areas with rare instances of tired structures that had little impact on the overall physical and economic character of the area. Creation of a project area involving just a few isolated parcels in this condition is neither legally nor fiscally viable, so staff directed RSG to focus its efforts on a more comprehensive study of the Village Area.

Accordingly, this redevelopment feasibility study ("Study") assesses the legal and financial implication of formulating a redevelopment project area for the Village Area ("Survey Area") including:

- Reasons for Redeveloping the Survey Area
- Preliminary Urbanization Analysis
- Preliminary Findings of Physical and Economic Blight
- Initial Financial Feasibility Analysis

BACKGROUND

Set against the eastern foothills of Santa Cruz, the City of Saratoga can trace its history back to 1848. In the early 1900's, Saratoga had a reputation of being a beautiful vacation destination and an agricultural center. However, in the 1950's with the rise of single-family homes and industrial developments the community experienced considerable growth and rapid expansion. In 1956, the community of Saratoga incorporated to secure its autonomy and avoid being overtaken by the City of San Jose.

Much of the development that the community experienced in the 1950's occurred outside of the historic center of town along what is now known as Big Basin Way where a variety of retail, tourist, and entertainment uses developed to service the needs of the community.

In more recent decades as competition from larger, more integrated shopping areas developed, the Village began a steady period of stagnation. Some businesses relocated out of the area while others went out of business. While the area today still retains much of its historic charm, the Village, like many of the other retail areas of the community became less patronized by local consumers. Moreover, the older structures have increasingly become a limitation for businesses as they lack modern amenities such as internet access and utilities that limit the usability of these properties.

In an effort to identify fiscal resources to combat these trends and stimulate economic development initiatives, the City initiated this study of the Survey Area to assess the viability of establishing a redevelopment project area.

In total, the Survey Area is approximately 109.25 acres in size, and encompasses the Big Basin Way corridor, from Saratoga-Sunnyvale Road to Stoneridge Drive as well as adjacent areas to the north and south. Though retail concerns led to the designation of this Survey Area, much of the property is currently in residential use; commercial uses are largely concentrated along Big Basin Way. Approximately 328 (72.2 percent) of the 454 parcels in the Survey Area are in residential use, including 84 condominiums located at various areas within the Survey Area. Retail uses comprise 54 parcels, and office uses account for another 25 parcels.

A breakdown of the Survey Area by land use is presented in Exhibit 1.

EXISTING LAND USES **Exhibit 1**

Village Redevelopment Project Area

Land Use	2004-05 Secured Assessed Value	Residential Units	Parcels	Net Acreage	%
Residential	$185,158,704	377	328	67	61%
Single Family Dwellings	*$139,639,692*	*233*	*233*	*57*	*52%*
Condominiums	*$40,279,432*	*84*	*84*	*3*	*3%*
Multi-family dwellings	*$5,239,580*	*60*	*11*	*7*	*6%*
Commercial	$32,745,976		54	13	12%
Office	$16,182,828		25	7	6%
Vacant	$1,358,847		22	11	10%
Public	$365,605		25	12	11%
TOTAL	**$235,811,960**	**377**	**454**	**110**	

Source: MetroScan.

For the past decade the City has attempted to revitalize the area from years of economic decline struggling with neighboring cities in both Los Gatos and San Jose for the attraction of commercial businesses and development. Despite their efforts, the Survey Area continues to suffer from a reduction in activities such as: cultural events, civic infrastructure, pedestrian traffic, local retail and dining. Factors related to the decline of the Survey Area, which have hindered the economic viability of commercial properties include:

- the historic pattern of commercial development;
- the development or growth of personal services and lack of mixed retail at the expense of retail shops;
- decrease of traffic or visitors to the Survey Area due to the construction of Highway 85; and
- a lack of maintenance and rehabilitation of properties managed by absentee landlords.

This study focuses on two chief legal factors that communities must consider before proceeding with redevelopment, specifically urbanization and blight. These requirements and our findings are summarized below.

URBANIZATION

The Law mandates that no less than 80 percent of the land in a redevelopment project area be urbanized. Urbanized properties are defined as parcels that are presently or previously developed with urban uses, parcels of irregular form under mixed ownership, and properties that are an integral part of an urban area (i.e. substantially surrounded by developed property).

Applying these criteria to the Survey Area, RSG estimates that approximately 109.25 acres or 100 percent of the Survey Area are urbanized, in that they are either properties developed with urban uses or properties that are vacant but surrounded by developed properties on three or more sides. The Survey Area contains no land dedicated to agricultural or open space use. Based on the previously mentioned figures, the proposed Survey Area is predominantly urbanized, as it clearly exceeds the 80 percent urbanization requirement.

PRELIMINARY FINDINGS OF PHYSICAL AND ECONOMIC BLIGHT

Legal Requirements

In 1945, the Community Redevelopment Act was enacted by the California State Legislature to enable local governments to redevelop urban areas that for many reasons, have suffered from unsafe, unfit, deteriorated, and economically dislocated buildings and properties. The initial growth in redevelopment was slow with only 46 redevelopment agencies established by 1965. Today it is estimated that over 400 redevelopment agencies exist with approximately 780 project areas.

Redevelopment was traditionally intended for severe conditions of blight such as that existing in inner cities like Bunker Hill in Los Angeles, and the Embarcadero area of San Francisco. Over the years, as redevelopment became more popular, cities used redevelopment as a funding mechanism in areas that did not meet the traditional views of blight. In the 1970s and 1980s, many cities placed suburban and semi-rural areas into redevelopment by arguing that these areas lacked public infrastructure. A public backlash developed in the early 1990s resulting in legislation that clarified the definition of blight. In 1993, the State Legislature adopted the Community Redevelopment Law Reform Act (AB 1290); this legislation mandated findings in both physical and economic blight.

Prior to AB 1290, a blighted area was characterized by one or more conditions set forth in Health and Safety Code Sections 33031 and 33032, causing a reduction of, or lack of, proper utilization of the area that it constituted a physical, social, or economic burden on the community. The definition of blight was so vague that it allowed project areas to be characterized as blighted without the presence of substantial physical deterioration.

Under AB 1290, the definition of blight was amended for project areas adopted after January 1, 1994. As it exists today, Health and Safety Code 33031 provides that a blighted area must contain both physical and economic blight. Specifically, the conditions set forth in Section 33031 must be so prevalent and substantial to cause a reduction of, or lack of, proper utilization of the area to the extent that it constitutes a serious physical and economic burden to the community. This burden cannot be expected to be reversed or alleviated by private enterprise, governmental action, or both, without redevelopment.

The implication of AB 1290 cannot be overlooked; new project areas must conform to a significantly higher threshold of blight and urbanization than what was previously permitted by Law. Indeed, many project areas created prior to redevelopment reform in 1994 could not meet today's legal requirements. As a result, it is much more difficult to create a redevelopment project area under today's legal requirements.

Study Approach and Methodology

Several data sources were utilized to measure existing conditions in the Survey Area. In July 2004, RSG staff conducted a field survey and research of the Survey Area to ascertain on a preliminary basis whether physical and economic blighting conditions are present. Overall, it is our conclusion that the Survey Area has one physical blighting condition, namely factors that hinder economically viable use or capacity of buildings or lots, but this condition cannot be deemed to be pervasive to pose a serious burden on the community, as required by Law. No economic blighting conditions are present in the Survey Area.

The results of the field survey, as well as other data collected, are described below and are presented within the same categories as defined in the CRL. Also, an explanation of the method used for assessing these conditions is provided by category. A more comprehensive study of the Survey Area would be necessary in the course of preparation of a redevelopment plan, as required by Law.

As defined in Section 33031 of the Law, blight encompasses physical and economic conditions that cannot be alleviated by private enterprise, governmental action or both, without redevelopment. Section 33031 also defines these physical and economic conditions as follows:

Physical blight is defined as:

- Buildings in which it is unsafe or unhealthy for persons to occupy, live, or work. These conditions include serious building code violations, numerous structures that are dilapidated or severely deteriorated, numerous structures that exhibit defective design or physical construction, faulty or inadequate utilities, or other similar factors.

- Factors that prevent or substantially hinder the viable use or reuse of buildings or lots. This condition can be caused by substandard building design, inadequate parcel size, nearby insufficient parking, or other similar factors.

- Adjacent or nearby uses that are incompatible with one another, and prohibit the economic development of adjoining parcels.

- Lots subdivided into irregular shapes and are inadequately sized for proper usefulness and development. Further, these lots are often under multiple ownership.

Economic blight is defined as:

- Depreciating or stagnant property values or impaired investments. Properties whose value is impacted by hazardous wastes and materials also fall under this category.

- Abnormally high business vacancies, abnormally low lease rates, high turnover rates, abandoned buildings, or excessive vacant lots within an area developed for urban use and served by utilities.

- The lack of commercial facilities that are normally found in neighborhoods, including grocery stores, drug stores, and banks and other lending institutions.

- Residential overcrowding or an excess of bars, liquor stores, or other businesses that cater exclusively to adults and generate public safety and welfare problems.

- A high crime rate that constitutes a serious threat to the public safety and welfare.

In addition to the aforementioned conditions, inadequate public infrastructure is also considered a condition of blight when other physical conditions are present.

Blighting Conditions within the Survey Area

In July 2004, RSG conducted a parcel by parcel field survey to locate and evaluate the exterior blighting conditions in the Survey Area. In addition, RSG studied ownership and parcel configuration, investigated the extent of documented hazardous contamination, interviewed local brokers, analyzed business turnover data, analyzed crime and code violation data, and analyzed documents provided by the City.

As discussed below, virtually all of the physical and economic blighting conditions in the Survey Area exist among the retail properties along Big Basin Way, and most of these were not particularly severe. Less than a handful of residential units were anything less than sound and attractive properties; the rare instances of tired or deficient residential uses did not warrant their inclusion in a redevelopment project area.

Physical Conditions

- Buildings in which it is unsafe or unhealthy for persons to live or work: With the exception of less than a handful of commercial structures along Big Basin Way, Survey Area buildings are in sound condition and cannot be described as unsafe or unhealthy. City Code Enforcement did not identify any serious code violations in the area. While property owners and business owners acknowledged that many of the buildings would benefit from façade improvements or structural upgrades to modernize their appearance and use, this circumstance alone does not justify redevelopment.

- Factors that Hinder Economically Viable Use:

  Substandard Design: Many of the buildings located along the commercial district on Big Basin Way predate 1960, and their age and antiquated design detracts from the economic viability within the Survey Area. The commercial district represents 8 percent of the Survey Area, according to data obtained from County Assessor's records. Of these retail properties, 60 percent are older than 40 years old. These historic buildings are generally more difficult to rehabilitate due to years of improper maintenance, aging, and the costs associated for the need to bring the structure up to current building code requirements.

  However, the Law requires that a project area that has these conditions be also shown to link the presence of these physical problems to the economic viability of the area. Property values have not been detrimentally affected, nor did real estate brokers surveyed by RSG express any reservations that these conditions were not serious enough to prevent users from locating in the area.

  According to the California Retail Survey, retail sales over the past five years have grown 62.4 percent Countywide, but only 47.7 percent statewide. By comparison, the Retail Survey reports that retail sales in Saratoga have grown by 43.6 percent over the same period. (Statistics for the Survey Area alone are not available from the Retail Survey.) Other Cities in the County have experienced growth ranging from 17.1 percent (Los Altos Hills) to 86.4 percent (Los Gatos), placing Saratoga generally in the middle of the pack. These statistics suggest that while Saratoga is certainly behind some of its neighbors in retail sales volume, it cannot be characterized as a community with little or no growth.

Also, although there is some perception that turnover rates in the Survey Area are high, in fact an analysis of business licenses renewals indicated that its 10.25 percent turnover rate is actually comparable or even better to national and state trends. According to the U.S. Small Business Administration, business failure rates in 2003 were 9.8 percent nationally, but 13.7 percent statewide.

Indeed, the Survey Area does tend to cater to more startup businesses that can have a higher failure rate than established retailers located in other parts of the market area, but actual turnover rates suggest that in most cases businesses in the Survey Area fare better than those statewide. So, while some users may not be suited for the Village today, such as larger destination retailers or upscale shops, this fact alone does not warrant creation of a project area in a location where a number of businesses have remained successful and continue to open up.

Lack of Available Parking: In July 2002, the City hired a consulting group to conduct a parking survey to evaluate the parking supply in the Survey Area to determine if it is sufficient to accommodate the existing demand. The results showed that both on-street parking and district lots provided ample parking for patrons, with the exception of two of the five parking lots reaching capacity on the weekend during lunch and dinner hours. Since many mid range and upscale restaurants have been successful in the area for some time, it does not appear that parking is an acute problem in the Survey Area.

- <u>Incompatible Uses and Inadequate Lots</u>: There were no examples of incompatible uses that prohibited the economic development in this area, nor any evidence of lots of irregular shape, form, and size under multiple ownership.

Economic Conditions

- <u>Depreciated/Stagnant Property Values and Low Lease Rates:</u> RSG did not identify any examples of depreciated or stagnant property values. Local brokers reported that demand for small shop space in the Survey Area was still reasonably strong, and many entrepreneurial investors were willing to open up shop in the Survey Area even though this occasionally meant forgoing some modern amenities like ADA accessible restrooms and internet infrastructure. Leasing activity in the area is also strong. According to CB Richard Ellis market studies for 2003, the greater San Jose market area has lease rates that averaged $2.26 per square foot. By comparison local brokers quoted Survey Area lease rates in this range and even higher for properties with newer amenities. As a result, RSG could not identify quantifiable data to support any argument that the area materially suffers from depreciated or stagnant property values.

- <u>High Vacancies, Low Lease Rates, and High Turnover Rates:</u>

  Abnormally High Vacancy Rates: Vacancy rates in the region ranged from 4 to 7 percent according to brokers interviewed by RSG. By comparison, vacancy rates in the Survey Area were towards the higher end of this scale (averaging 6.5 percent according to brokers interviewed by RSG), though this is expected in older strip commercial areas that tend to attract more startup businesses. Still, these statistics do not support any claim that vacancy rates in the Survey Area are abnormally high, even if they are higher than in past years in the district.

High Turnover Rates: As stated earlier, turnover trends in the Survey Area do appear to be comparable or better than national or statewide trends. Based on business license data, an analysis of business turnover rates was conducted covering a five year period from 2000-2001 to 2004-2005. The statistics are derived from the total occupiable tenant spaces compared to the amount of empty tenant spaces within the Survey Area during a given year. Over the 5 year period, Survey Area turnover rates averaged 10.25 percent annually. This rate is better than the statewide failure rate of 13.7 percent, and comparable to the national failure rate of 9.8 percent.

- Lack of Necessary Commercial Facilities: The Law defines a lack of necessary commercial facilities normally found in neighborhoods, such as banks, grocery stores or drug stores, as an indicator of economic blight. RSG's field survey did not identity any examples of the Survey Area lacking the necessary commercial facilities, which is typical in small redevelopment areas like the Survey Area. The Survey Area contains a smaller, if somewhat antiquated, market as well as several banks. Other grocery and drug stores are in close proximity to the Survey Area.
- Residential Overcrowding and Businesses that Cater to Adults: RSG did not identify any examples of residential overcrowding and businesses that cater to adults, such as adult businesses and bars.
- High Crime Rates: The Survey Area does not suffer from high crime rates.

Based on the foregoing analysis, the Survey Area lacks a significant level of physical blight or any economic blight to warrant proceeding with a redevelopment project area at this time. Moreover, given staff's desires to invest in streetscape and façade improvements to the area, these initiatives would do little to address the physical limitations of some buildings in the area. A more extensive level of redevelopment would be needed to address the problems in the area that would be the basis for its establishment, such as assembly and consolidation of improved and occupied properties to facilitate demolition and reconstruction. Given the typical negative reaction these type of initiatives face, proceeding with redevelopment under a cloud of questions on its merits would be politically and legally challenging.

INITIAL FINANCIAL FEASIBILITY ANALYSIS

Assuming additional data could be documented to support creation of a redevelopment project area in the Survey Area, redevelopment of the Survey Area would necessitate [redacted] Redevelopment Agency to collect tax increment revenue to underwrite redevelopment projects. To forecast the amount of tax increment revenues that the Survey Area could generate, RSG prepared the enclosed forecast under the following assumptions:

- Assuming a redevelopment plan adoption ordinance is adopted prior to July 20, 2006, the project area would have a 2005-06 base year value. Since 2005-06 assessed values were not available to RSG at the time of this study's preparation, RSG estimated the 2005-06 base year value using the 2003-04 secured roll of $235,811,960. The projected 2005-06 base year roll value used in this study is approximately $247,749,940.

- Future years' secured values were increased by 2.5% annually to account for appreciation due to resales and minor new construction. No growth was assumed for unsecured values due to their unpredictability, so this value was not included in our forecast.

- No new development was included in this forecast because of the speculative nature of potential projects at this time. Long term, major development within the Survey Area is likely with redevelopment efforts, and is obviously a desire of the Agency. Consequently, it is appropriate to anticipate additional tax increment revenues beyond those included in this forecast.

Based on these assumptions, the Agency could collect tax increment revenue from a redevelopment project area comprised of Survey Area properties beginning in fiscal year 2006-07 through fiscal year 2049-50. Over this time period, the Agency could receive a total of $90 million in gross tax increment revenue cumulatively. In current dollars, assuming a 6 percent discount rate, the gross tax increment revenue projection is equal to approximately $18 million. After mandatory payments to affected taxing agencies, the Agency would have $18 million available for affordable housing projects and $41 million for redevelopment projects. In current dollars the $59 million of affordable housing and redevelopment tax increment revenues equate to approximately $12 million.

Moreover, it is important to underscore that these financial projections likely overstate by more than 50% the probable amount of revenues the redevelopment agency could receive from redevelopment within the area, since over half of the Survey Area contains nonblighted residential property that could not be justifiably included in a redevelopment project area. At best, these projections should be considered highly optimistic.

As stated earlier, the limited factual basis for proceeding with redevelopment could create scrutiny among property owners that could be impacted by development. Likewise, affected taxing agencies have a financial motivation to be cautious about redevelopment in any community since they stand to lose property taxes. Saratoga would face these concerns on a more acute level, since the amount of property tax appreciation in the built out Survey Area would likely occur without redevelopment, so they would most likely see a loss of revenues even if redevelopment were successful. The taxing agencies most likely to challenge the City on these grounds (and potentially file a lawsuit against the redevelopment plan) would include Saratoga Union Elementary School District (which could lose approximately $14 million to redevelopment), Los Gatos High School District (which could lose approximately $11 million), the County General Fund (which could lose approximately $8 million), and Saratoga Fire District (which could lose approximately $6 million).

Again, because the Survey Area fails to meet the blight test, these potential revenues are for illustrative purposes only. Moreover, they exclude the costs of forming a redevelopment project area, which can range from $300,000 to more than $500,000 if a legal challenge is filed on the redevelopment plan.

We trust this information is helpful in your evaluation for redevelopment of the Survey Area. Should you have any questions, please do not hesitate to contact us.

Sincerely,
ROSENOW SPEVACEK GROUP INC.

Jim Simon
Principal