

CITY COUNCIL STAFF REPORT

MEETING DATE: June 21, 2023

PREPARED BY:

Matthew Mahood, Economic Development Director

APPROVED BY: City Manager

ADOPT A RESOLUTION TO AUTHORIZE THE CITY MANAGER TO EXECUTE AN IMPACT FEE FREEZE AGREEMENT, AND A SEWER/TRAFFIC IMPACT FEE FINANCING AGREEMENT WITH CUTINA MORGAN HILL LLC FOR A HOTEL DEVELOPMENT ON A 2.21 ACRE PARCEL IDENTIFIED BY ASSESSOR PARCEL NUMBER (APN) 726-58-006

RECOMMENDATION(S)

Adopt a resolution to authorize the City Manager to execute an Impact Fee Freeze Agreement and a Sewer/Traffic Impact Fee Financing Agreement with Cutina Morgan Hill LLC for a 114-room hotel development on a 2.21 acre parcel identified by assessor parcel number (APN) 726-58-006.

COUNCIL PRIORITIES, GOALS & STRATEGIES

City Council Ongoing Priorities

Maintaining and Enhancing Infrastructure

2022-2023 Strategic Priorities

Fiscal Sustainability

Economic Development

Guiding Documents

Economic Blueprint

Morgan Hill 2035 General Plan

REPORT NARRATIVE:

On June 21, 2017, the City Council adopted a Development Impact Fee Freeze Program. This program locks the impact fee to a specific date for a period of three years, giving the developer increased certainty as to the costs they will incur and creating an incentive to help offset the ever-increasing cost of new development. In return, the developer agrees to develop and apply for building permits within the three-year period.

On October 29, 2018, the City Council entered into a Fee Freeze Agreement with Evergreen Devco, Inc for the Evergreen Villages at the corner of Butterfield and Cochrane. This agreement locked the Impact Fees to the 2016/2017 Impact Fee

Schedule. Due to the COVID-19 pandemic and resulting economic conditions, the City has extended the Fee Freeze Agreement on two occasions through June 30, 2023.

To incentivize hotel development, in June 2022, the City Council adopted the Hotel Incentive Policy. Both incentive programs are consistent with the City's General Plan Update 2035 and the 2017 Economic Development Blueprint as new lodging facilities support the City's goals for tourism, and the viability of the City's sports and recreation facilities.

Details and Analysis:

In 2021, Cutina Morgan Hill LLC purchased 2.21 acres (APN 726-58-006) within the Evergreen Villages planned development area with the intent of building a new 114-room Holiday Inn Express. This is the same site that was previously entitled to a hotel but was never built due to the Covid-19 pandemic and resulting economic conditions. Cutina Morgan Hill, LLC has submitted plans to the City and is currently seeking building permits and project financing. Cutina Morgan Hill, LLC has requested that the City Council honor the 2018 Evergreen Devco Fee Financing Agreement with the 2016/2017 Impact Fee Schedule that was in place when they purchased the land and began their hotel project.

While the Cutina hotel project does not qualify for the Hotel Incentive Policy since all of the project's off-site improvements have already been completed, staff recommends the City Council approve an Impact Fee Freeze Agreement with the 2016/17 Impact Fee Schedule and instead of a three-year agreement, staff recommends an 18-month Fee Freeze Agreement. This will give Cutina LLC increased financial certainty and assist in getting this important project built. If authorized, Cutina will have until December 31, 2024, to apply for, and receive building permits and commence construction in order to benefit from the impact fee freeze extension. The estimated impact fees using the Fee Schedule for FY 2016-17 are \$734,879.

Once completed and operational, it is estimated the new 114-room Holiday Inn Express could generate in excess of \$30,000 in new property tax annually assuming a consistent land and construction valuation with similar sized projects. Property tax contributes to the City's General Fund. In addition, once operational, a new 114-room upper midscale hotel could generate in excess of over \$400,000 in transient occupancy tax (TOT) annually. The City collects 11% of Transient Occupancy Tax (TOT) on all hotel room revenue, which contributes to approximately 5% of the total General Fund revenue.

If the Developer applies for building permits before June 30, 2024, the estimated benefit received by the developer from the impact freeze is \$307,473. If the developer applies for building permits after June 2024 and commences construction, but before December 31, 2024, the estimated benefit of the impact freeze is estimated at \$349,167. If the developer applies for building permits after December 31, 2024, the impact fees in effect at that time will be applied so long as no extension is granted. The estimates assume that the City's Impact Fees will increase at a rate of 4% per year. While the developer receives cost savings for each year the project is deferred, it is very likely that the cost of construction will continue to escalate in the coming years and therefore, continued

delays on building permit submittal and delay in construction will likely cost the developer more than the savings received from an impact fee freeze.

Year	Agreement Base Year	2023 (05-15-23)	2024*
Impact Fee Schedule	2016/17	2023/24	2024/25
Impact Fee Estimate	\$ 734,879	\$ 1,042,352	\$ 1,084,046
Potential Savings to Development		\$ (307,473)	\$ (349,167)
*Estimated fee escalation of 4% per year			

Impact fees have been identified as a barrier to development in Morgan Hill, in particular “greenfield” development which requires significant infrastructure investment by the developer. To address this issue and to attract new industrial and commercial development, the City created the Fee Freeze Program, which would provide some amount of certainty to the development community, while still collecting impact fees to support the infrastructure needs of the City. By incentivizing development of these greenfields, the City can generate property taxes, sales taxes and Transient Occupancy Taxes from these vacant properties, supporting the City's fiscal sustainability.

Fee Deferral Program Guidelines

In 2006, the City Council created a Sewer and Traffic Impact Fee Financing Program (also known as the Fee Deferral Program) to facilitate commercial and industrial development and assist with development impact fees. The City Council has provided the City Manager authority to approve fee financing agreements for up to \$99,999. Projects that request financing of \$100,000 or more require City Council approval. The Program requires a 20% down payment at the time of permit and allows the remaining 80% balance to be paid over five years in monthly installments. The Sewer and Traffic Impact Fee Financing Program calculates interest at Local Agency Investment Fund (LAIF) + ½ percent, allowing the City to recover the lost interest it would have earned if the payment was made all at one time, plus ½%. The Program has been used by commercial developments/businesses over the years, including Madrone Village and several of the retail center's commercial tenants, Cochrane Animal Hospital, The Granary, 76 Gas Station at Cochrane Commons, Shoe Palace, Applied Motion, Alara Cellars, and most recently, Giorgio's Italian Grill and Pizzeria.

The impact fees for traffic and sewer on the 114-room hotel project on APN 726-58-006 total \$581,528. The Fee Deferral Program requires 20% to be paid at the time of building permit issuance. A deposit of \$116,306 would be required and the remaining \$465,222 balance would be repaid via monthly installments over five years at an interest rate calculated using the most recent monthly LAIF + 1/2 percent. With City Council approval of the Resolution authorizing the City Manager to execute the Sewer and Traffic Impact Fee Financing and Security Agreement, the developer will be able to move more quickly and with more financial certainty to complete the project.

Conclusion:

Approving a Fee Freeze Agreement and Fee Financing Agreement with Cutina Morgan Hill, LLC is consistent with the Impact Fee Freeze Program, the 2035 General Plan Policy ED-4-9: To support the construction of a full range of new lodging facilities, 2017 Economic Blueprint Tourism Strategy, and the Hotel Incentive Policy (HIP) that was adopted by the City Council in June 2022.

COMMUNITY ENGAGEMENT:

Inform

The table below addresses the requirements set forth in State of California AB 562 (Government Code 53083) for publication of information related to an economic development subsidy and public hearings.

Name/address of the beneficiary of the subsidy:	Cutina Morgan Hill, LLC 2801 Ocean Park #193 Santa Monica, CA 90405
Start and end dates, schedule for the subsidy:	The Sewer and Traffic Impact Fee Financing Agreement to start no later than December 31, 2024. The financing agreement is for a term of five years for \$465,222. The beneficiary will pay monthly payments over the course of five years.
Describe the subsidy, estimated total amount of expenditure of public funds or revenue lost:	The Sewer and Traffic Impact Fee Financing Agreement allows the beneficiary to make a 20% down payment on the Sewer and Traffic Impact fees and finance the balance over five years. The City charges the beneficiary an interest rate of the Local Agency Investment Fund (LAIF) + ½ percent. If the Sewer and Traffic Impact fees are not paid by the beneficiary, the City will collect pledged collateral to cover the balance of the sewer and traffic impact fees. In addition, future building permits will not be issued until all impact fees are paid. No anticipated expenditure of public funds or revenue lost as interest will be collected over the term of the financing agreement.
State of public purpose:	Expand and enhance economic opportunities for businesses in the City, continue to expand the City's employment base, enhance tourism and tourism opportunities, and continue to generate the hereinafter defined Property Tax, Sales Tax and Transient Occupancy Tax that the City can utilize to fund general governmental services such as police, fire, street maintenance, and parks and recreation programs.
Projected tax revenue:	The projected increase in property tax collected from improvements to this site is approximately \$30,000 annually. In addition, a new 114-room hotel could generate approximately \$400,000 in

Estimated number of jobs created by subsidy:

new Transient Occupancy Tax (TOT) annually. The hotel construction will generate approximately 100 temporary construction jobs and approximately 30 new full-time hospitality related jobs.

ALTERNATIVE ACTIONS:

The City Council could choose not to enter into a Fee Freeze Agreement with Cutina Morgan Hill, LLC. This option could potentially save the City at minimum \$307,473 in impact fee revenue, but it also puts the 114-room hotel project at risk of not being completed.

The City of Morgan Hill could choose to use a different fee schedule other than the FY 2016/17 Fee Schedule for the Fee Freeze Agreement with Cutina Morgan Hill, LLC.

The City Council could choose not to approve the Sewer/Traffic Fee Financing Agreement which would require the developer to pay the proposed financing balance of \$581,528 immediately in order to receive building permits.

PRIOR CITY COUNCIL AND COMMISSION ACTIONS:

In February 2006, the City Council created the Fee Financing (Deferral) Program to stimulate commercial/industrial development. The existing program was modified in July 2009 to provide additional enhancements to projects both inside as well as outside the former Redevelopment Project Area

In June 2017, the City Council approved the Citywide Impact Fee Freeze Program establishing FY 2016-17 Development Impact Fees as the basis for the three-year term for any new commercial/industrial development project that enters into a Development Agreement for an Impact Fee Freeze approved by City Council.

In October 2018, the City Council approved a three-year Fee Freeze Agreement with Evergreen Devco on the 20- acre Evergreen Villages commercial center at the corner of Butterfield Blvd and Cochrane Road. Due to the COVID-19 pandemic, the City manager approved two one-year extensions of the Fee Freeze Agreement pursuant to City policy.

In June 2020, City Council reviewed the Impact Fee Freeze Program and established FY 2017-18 Development Impact Fees as the basis for the three-year term for any new commercial/industrial development project that enters into a Development Agreement for an Impact Fee Freeze approved by City Council.

In May 2022, City Council received an update on the Impact Fee Freeze Program. At

this time, the City Council established and locked City's Impact Fees to the Impact Fees at the time of the executed agreement for up to three years for new industrial and commercial development provided the prospective development secures entitlements and submits for building permits within three years of the date of the agreement.

In June 2022, the City Council approved the Hotel Incentive Policy in alignment with Morgan Hill's 2035 General Plan and 2017 Economic Blueprint which identify Tourism as a targeted industry and defines specific strategies and actions that should be taken to support, nurture, and advance this industry sector.

FISCAL AND RESOURCE IMPACT:

While the potential loss of revenue to the City from entering into this Impact Fee Freeze Agreement is expected to range between \$307,473 to \$349,167, securing the hotel development will yield multiple benefits for the city. The City expects to receive a one-time construction benefit of construction jobs and ancillary economic impact in the form of sales tax from local spending. Once operational, the City may receive an ongoing annual benefit of approximately \$30,000 in Property Tax collections and over \$400,000 in Transient Occupancy Tax (TOT) to the City's General Fund.

CEQA (California Environmental Quality Act):

Not a Project

An Environmental Impact Report (EIR) for the Morgan Hill 2035 Project, which included the General Plan Update, was prepared in accordance with the California Environmental Quality Act (CEQA) and certified by the Morgan Hill City Council on July 27, 2016. Commercial and industrial development as discussed above is consistent with the general plan policies for which the EIR was certified. There is no substantial evidence that freezing impact fees will have a significant effect on the environment beyond that already analyzed in the certified EIR; therefore, no further environmental analysis is required.

Any project specific development that occurs in the future will undergo an independent analysis pursuant to the requirements of CEQA.