APPLIED ECONOMICS

ECONOMIC AND REVENUE IMPACTS OF ONE SOUTH CHURCH ON THE RIO NUEVO DISTRICT AND THE CITY OF TUCSON

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1.0 INTRODUCTION

Applied Economics was retained by the Rio Nuevo Multipurpose Facilities District (the District) to perform an analysis of the renovation of the existing Class A office building at 1 South Church Avenue to include a new 145-room hotel along with updated office space. This analysis quantifies the economic and revenue impacts that could be created by the project.

1.1 Project Description

The proposed One South Church project would include a new 90,000 square foot business class hotel with a restaurant on floors 1 and 2 and 5 through 9 of this 23-story building. The remaining 152,000 leasable square feet of multi-tenant office space on floors 10 through 23 would be updated to be more competitive with other newer office buildings in the downtown area. The 495 underground structured parking spaces would not be impacted by the project (Figure 1).

This analysis assumes that construction will begin in September/October 2020 for the hotel and April 2020 for the office renovation. The office renovation would be completed in approximately three months and the hotel could be operational by September 2021. The total capital investment for this project is estimated at $31.1 million including construction, tenant improvements and relocation costs and other soft costs.

The amount of leasable office space would be reduced from approximately 241,000 square feet to 152,000 square feet, although all of the existing tenants would be consolidated into the new smaller space, so there would be no change in the number of office jobs supported by the project. However, there would be approximately 52 new jobs associated with the hotel.

FIGURE 1
DEVELOPMENT ASSUMPTIONS

	Current Square Feet	Future Square Feet	Estimated Net Jobs	ADR	F&B Sales per Room Night	Lease Rate	Current Occupancy	Projected Occupancy
Hotel (145 rooms)	0	89,792	52	$186	$56	na	0%	77%
Office	241,355	151,563	0	na	na	$27	55%	86%
Common Area	44,166	44,166	0	na	na	$0	0%	0%
Parking (495 spaces)	na	na	0	na	na	$804	0%	100%
Total	285,521	285,521	52	na	na	na	na	na

Note: ADR for hotel is for year 3 when stabilized occupancy is reached. Parking lease rates are per space per year for year 3. It is assumed that room rates and lease rates will increase by 3 percent per year.

2.0 IMPACT SUMMARY

The renovation of this iconic, but underperforming, Class A office tower at 1 South Church Avenue in Tucson will result in an increase in tax revenues to the city and the District.

- About 165 direct construction jobs and approximately 85 additional indirect construction jobs could be supported in the City of Tucson during the construction period in 2020 and 2021. The total construction impact is estimated at $30.6 million.

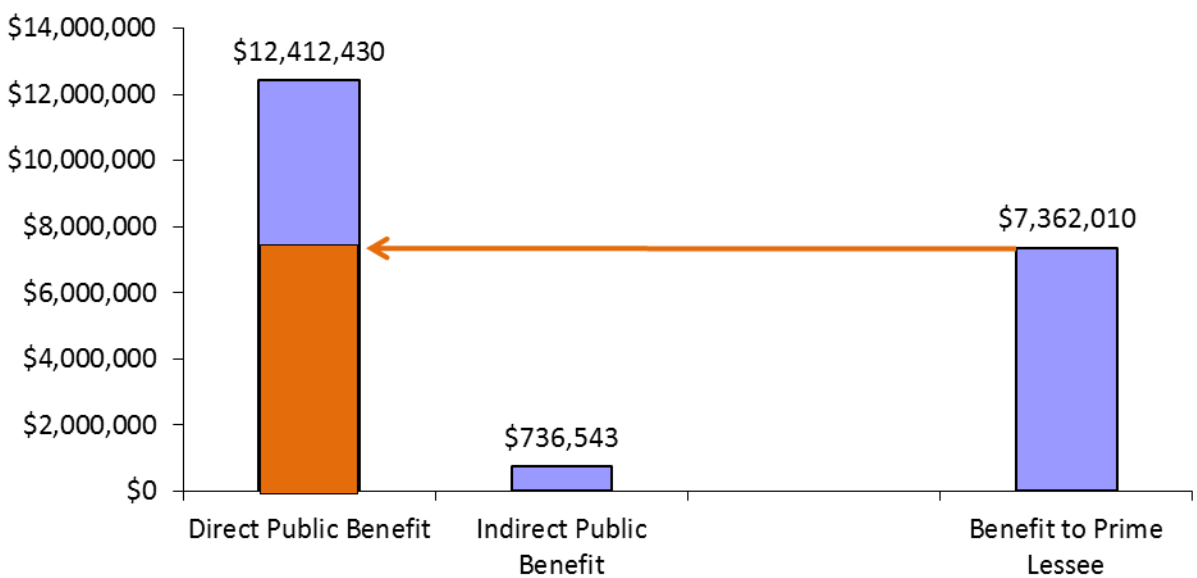
- Once completed, the new hotel could generate a net annual economic impact of $8.2 million. The result would be an estimated net gain of 52 direct jobs. The hotel operations could support an additional 22 indirect and induced jobs at other local businesses.

- In terms of local tax revenues, the property is current generating an estimated $128,000 in annual sales taxes to the city and RTA from office and parking lease revenues and $580,000 in property taxes to the city, county and school district.

- Following the renovation, the amount of sales tax revenues generated by this property would increase significantly as a result of the new hotel, plus there would be city lodging taxes on the room revenues. Over the next eight years, the project could generate an estimated $12.4 million in net new sales and lodging taxes to state and local governments.

- The developer is requesting a GPLET agreement with the District that would result in the exemption of property tax and the abatement of lease excise taxes for eight years. In order to qualify for this type of GPLET agreement, it is necessary to show that the project will create an economic and fiscal benefit to the city, county and state during the term of the agreement, and that the improvement will result in an increase in property value of at least 100 percent per A.R.S. 42-6209. Based on the appraisal for the current and future office and hotel components provided by the CBRE, there would be more than a 100 percent increase in market value. In addition, the projected amount of tax revenue or public benefit that could be generated over the next eight years is $5.1 million more than the estimated benefit to the prime lessee in terms of the value of the GPLET property tax savings, thereby meeting the statutory requirement (Figure 2).

FIGURE 2
VALUE OF GPLET



3.0 ECONOMIC IMPACT ANALYSIS

The economic impacts resulting from One South Church include both the one-time construction impacts and on-going operations impacts. These impacts are quantified in terms of direct and indirect jobs, labor income and output that would be generated by the tenants. Indirect impacts are the result of the multiplier effect and capture supported supplier and consumer businesses in the District and the City of Tucson that would by impacted the new development.

3.1 Construction Impacts

The proposed construction costs for this project are estimated at $31.1 million. Of that total, $20.0 million of construction spending, excluding tenant relocation, FF&E, interest and other soft costs, has the potential to generate local economic impacts.

Construction is expected to be completed in 2021. The multiplier effects of this construction spending could generate a total increase in economic activity of about $30.6 million between in 2020 and 2021 (Figure 3). The approximately 165 direct jobs and 250 indirect and induced jobs could result in about $11.6 million in labor income in the City of Tucson during the construction period.

FIGURE 3
CONSTRUCTION IMPACTS OF ONE SOUTH CHURCH

	Direct Impacts			Total Impacts		
	Expenditures	Jobs	Labor Income	Output	Jobs	Labor Income
Hard Costs & Contingency	$15,069,000	132	$5,847,525	$21,860,615	182	$7,952,824
Soft Costs	$4,885,000	33	$2,349,195	$8,751,819	67	$3,692,170
Total	$19,954,000	165	$8,196,720	$30,612,434	250	$11,644,994

3.2 Operations Impacts

Once construction is completed, the proposed office and hotel development could support an estimated 594 permanent jobs based on the assumptions used in this analysis. However, this analysis focuses on the net jobs. The approximately 542 office jobs will remain unchanged as the existing tenants are consolidated into the renovated office space. However, there would be an estimated 52 new jobs associated with the hotel that will create a net new economic impact.

The net economic impacts from on-going operations of the hotel are shown in Figure 4. The annual direct output from the hotel is estimated at $5.4 million. The multiplier effect of this net increase in business activity could result in a total economic impact of $8.2 million per year. This would be accompanied by approximately 74 direct, indirect and induced jobs and a $2.4 million increase in annual labor income in Tucson.

FIGURE 4
NET OPERATIONS IMPACTS OF ONE SOUTH CHURCH

	Direct Impacts			Total Impacts		
Year	Output	Net Jobs	Labor Income	Output	Jobs	Labor Income
2021	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2022	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2023	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2024	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2025	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2026	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2027	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
2028	$5,417,460	52	$1,583,517	$8,158,163	74	$2,435,039
Total	$43,339,676	52	$12,668,137	$65,265,304	74	$19,480,315

Note: Labor income does not include benefits.

The differences between direct and total economic impacts are called multiplier effects. Multiplier effects are a way of representing the larger economic effects on the local economy. The multiplier effects translate a change in output into a corresponding change in jobs and labor income. The total change in output includes the impacts on other local supplier and consumer businesses.

4.0 REVENUE IMPACTS

The One South Church project would generate new sales and lodging taxes for the city, RTA, Rio Nuevo District and the state. In total, the office, hotel and parking components combined could generate approximately $7.1 million in direct revenues to the city, $2.5 million to the District, $441,000 in additional revenues to the RTA, and $2.5 million to the state over the next eight years, which is the term of the proposed GPLET agreement. *It is very important to note that these are net revenues, meaning that they represent taxes over and above the amount already being generated by the building in its current state of operations.*

4.1 Direct Net Revenues

Direct net revenues from office, hotel and parking are estimated at $12.4 million from 2020 to 2028, including sales and lodging to the city, RTA and state (Figure 6). This building, which is located in the city's Central Business District, could be eligible for a GPLET agreement that would exempt it from real property taxes and abate lease excise taxes for eight years if it can be demonstrated that the renovation and re-purposing would increase the property value by more than 100 percent, and that it would generate a net fiscal benefit to state and local governments.

The project could generate total one-time sales taxes from new construction estimated at about $274,000 to the District, $304,000 to the city and RTA, and $274,000 to the state in 2020. There would also be on-going sales taxes on lease revenues from the office. Projected revenues from the approximately 152,000 square feet of renovated office space, less current sales taxes based on actual leases of $3.7 million, would result in a net gain of about $206,000 over eight years in terms of sales taxes generated by the office space.[1] *Note that this estimate assumes an 86 percent stabilized office occupancy rate throughout the 8 year period.*

On-going sales tax revenues associated with the new hotel and restaurant are estimated at $2.4 million to the city and RTA and $5.0 million to the state and the District over the eight year period.[2] There would be an additional 6 percent bed tax on room revenues plus $4 per day per room resulting in estimated bed tax revenues to the city of $4.6 million over eight years. These tax estimates assume an ADR of $175 in year one, increasing to $229 by year 8 with a stabilized occupancy rate of 77 percent by year 3. Food and beverage and other taxable sales at the hotel are estimated at $2.3 million in 2022 (first full year of operations), increasing by 2.5 to 3.0 percent per year during the GPLET term. Information on hotel operations was based on the operating pro-forma in the CBRE appraisal issued in February 2020.

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[1] *Note that leases are only taxable at the city and county level, and so the office does not generate any sales taxes to the state or the District.*

[2] *The District receives half of the 5.6 percent state sales tax on sales within the District above the base.*

FIGURE 6
NET STATE AND LOCAL REVENUE IMPACTS OF ONE SOUTH CHURCH

	City of Tucson				Rio Nuevo	RTA		State		
	Property	Sales	Lodging	Total Benefit	TIF	Sales	Total Benefit	Sales	Total Benefit	Total Public Benefit
Total	**$0**	**$2,442,436**	**$4,628,526**	**$7,070,962**	**$2,450,442**	**$440,584**	**$440,584**	**$2,450,442**	**$2,450,442**	**$12,412,430**
2020	$0	$254,666	$0	$254,666	$274,256	$48,974	$48,974	$274,256	$274,256	$852,152
2021	$0	$79,226	$129,822	$209,048	$80,884	$14,154	$14,154	$80,884	$80,884	$384,969
2022	$0	$254,557	$580,739	$835,296	$262,714	$45,419	$45,419	$262,714	$262,714	$1,406,142
2023	$0	$281,055	$617,511	$898,566	$284,696	$50,262	$50,262	$284,696	$284,696	$1,518,220
2024	$0	$289,601	$631,155	$920,756	$291,129	$51,791	$51,791	$291,129	$291,129	$1,554,805
2025	$0	$303,070	$645,190	$948,260	$300,321	$54,265	$54,265	$300,321	$300,321	$1,603,167
2026	$0	$316,994	$659,655	$976,649	$309,384	$56,822	$56,822	$309,384	$309,384	$1,652,239
2027	$0	$325,550	$674,554	$1,000,105	$318,720	$58,343	$58,343	$318,720	$318,720	$1,695,888
2028	$0	$337,715	$689,901	$1,027,616	$328,338	$60,554	$60,554	$328,338	$328,338	$1,744,847

4.2 GPLET Impacts

In addition to calculating revenue impacts to local and state governments, this analysis also considers the fiscal impacts of the GPLET relative to the amount of benefit to the prime lessee. A.R.S. 42-6209 requires that the economic and fiscal benefit to the state, county and city in which the government property improvement is located will exceed the benefits received by the prime lessee. If the project meets the statutory requirements and is approved for an eight year GPLET, the lessee would pay no lease excise tax or real property tax during this term. In addition to the economic and fiscal benefit, the project must be located in a Central Business District (which it is) and the improvement must increase the value of the property by at least 100 percent.

In order to meet the fiscal benefit requirements, it is necessary to show that total revenues to the state, county and city would exceed the benefit to the prime lessee (in the absence of a GPLET) during the term of the agreement. Revenues from the project include direct sales tax revenues from construction, on-going retail sales and lease taxes, and bed taxes on hotel room rentals. Over the eight-year term, the estimated direct revenues to state and local jurisdictions total $12.4 million (Figure 7). *This represents net revenues in excess of the taxes currently generated by the building.*

In comparison, the property tax savings to the developer is estimated at $7.4 million over the eight year term. Of the total property tax savings, $663,000 would have gone to the City of Tucson. The value of revenues generated by the project is $5.1 million more than the benefit of the GPLET to the prime lessee, thereby meeting the statutory requirement.

The foregone property tax revenues were estimated based on limited property value (LPV) per square foot for the subject property based on comparable offices and hotels in the CBRE appraisal. An average limited property value of $15.0 million was used for the renovated office space and a value of $9.2 million was assumed for the hotel. This would result in a total post-renovation LPV estimate of $24.2 million.

It is assumed that the value would increase by 5 percent per year over the next eight years, based on recent increases in LPV for the comparable properties and statutory guidelines. It is important to note that limited property value, which forms the basis for property taxes in Arizona, is generally less than full cash value and it not intended to be an estimate of the market value of the property.

FIGURE 7
EIGHT-YEAR VALUE OF GPLET FOR ONE SOUTH CHURCH

	Benefits to the City of Tucson	Net Benefit to Rio Nuevo	Benefits to RTA	Benefits to the State	Total Benefit to the City, County, Rio Nuevo, RTA and State	Benefit to Developer (Property Tax Savings)[1]
Total Direct	**$7,070,962**	**$2,450,442**	**$440,584**	**$2,450,442**	**$12,412,430**	**$7,362,010**
2020	$254,666	$274,256	$48,974	$274,256	$852,152	$667,661
2021	$209,048	$80,884	$14,154	$80,884	$384,969	$701,044
2022	$835,296	$262,714	$45,419	$262,714	$1,406,142	$736,097
2023	$898,566	$284,696	$50,262	$284,696	$1,518,220	$772,901
2024	$920,756	$291,129	$51,791	$291,129	$1,554,805	$811,546
2025	$948,260	$300,321	$54,265	$300,321	$1,603,167	$852,124
2026	$976,649	$309,384	$56,822	$309,384	$1,652,239	$894,730
2027	$1,000,105	$318,720	$58,343	$318,720	$1,695,888	$939,466
2028	$1,027,616	$328,338	$60,554	$328,338	$1,744,847	$986,440

[1] Based on a property tax rate of 15.3376% in tax rate area 0163.

In order to qualify for this eight year GPLET with an abatement of lease excise taxes, it is necessary to demonstrate that the improvements to the building increase the property value by at least 100 percent. The current market value of the office in “as is” condition is estimated at $33.3 million in the appraisal prepared by CBRE in February 2020. The appraisal estimated the “as complete” market value of real property for the office and hotel components at $71 million, resulting in a 112 percent increase in projected market value.

4.3 Summary

The proposed construction of a new hotel in a portion of the existing One South Church office building, and the renovation of the remaining office space within that building, as described in this analysis would create net revenue benefits for the District and the city, as well as economic benefits based on the new hotel jobs.

The project would increase the market value of the building by more than 100 percent, and the projected net tax revenues over the next eight years are projected to be $5.1 million greater than the value of the GPLET to the prime lessee measured in terms of lost property tax revenues to the city, county and school districts. Therefore, the proposed project meets the statutory requirements for an eight year GPLET agreement based on the current operating pro-forma.