

Report of the City of Prescott Citizen's Committee assigned to review the report titled "Fiscal Impacts Of The Granite Dells Ranch Annexation Area On The City Of Prescott" prepared by the firm of Applied Economics

Background: During 2008 the Prescott City Council approved an update of a portion of its annexation requirements relating to cost-benefit analysis. A portion of that update requires the establishment of an independent committee to review and submit a written report regarding the (1) completeness of the submission and (2) validity of the assumptions made. Following receipt of a proposal to annex a 340 acre portion of the Granite Dells Ranch, the City engaged the firm of Applied Economics to conduct the required cost-benefit analysis and appointed an independent committee comprised of John Danforth, William Kendig and Sidney Moglewer ("the Committee") to review this analysis. The following report is submitted by the Committee in fulfillment of its assignment to opine on the completeness of the report and validity of the assumptions underlying the Applied Economics analysis of the proposed annexation.

Activities of the committee: An initial draft of the Applied Economics analysis of the fiscal impacts of the proposed annexation ("the Applied Economics analysis" or "the Report") was submitted and copies were provided to members of the Committee on January 14, 2009. Each committee member reviewed the Report independently and discussed it with other committee members and/or with city staff. On January 27, 2009 the committee members met and discussed their independent observations regarding completeness of the Report and the validity of its assumptions. Following that the committee and three City of Prescott employees met, on January 30, 2009, with a representative of Applied Economics. After discussing a number of matters, the Applied Economics representative agreed to make several changes to the draft Report and to resubmit it. The Report was resubmitted the next week. Again, the committee members independently reviewed the Report. This was followed by another meeting, to discuss the revision, and to develop our conclusions regarding the completeness of the Report and the validity of its assumptions. Note that, while members of the committee did test selected calculations, they deemed it beyond the scope of their assignment to examine and validate all of the financial calculations contained in the Report. Our conclusions are set forth below.

A. Completeness of the report: In our opinion, the Report complies fully with the procedures specified in the City's Annexation Review Policy with one exception. Specifically, we were disappointed in the Report's discussion of possible non-quantifiable factors. At a minimum, we believe the discussion of non quantifiable factors in Section 1.3 should have highlighted some of the general economic uncertainties that could have significant impacts on our area's continued growth. Examples of these sources of uncertainty include: the economic impact of a major recession lasting more than 7 years, global -warming- caused severe economic impacts that responsible scientific observers have warned could begin within 10 years, and the impact of a major inflation induced by government printing of money to cover excessive Federal deficits. Although it is not possible to quantify the likelihood that any of these scenarios might be realized during the relevant time horizon, the fact that these and other unspecified risks exist should be considered by the Council for effective decision-making. We address at least one aspect of this omission in our discussion of "Completion Risk" below.

These impacts are in addition to the possible impacts of deficient water supply already under major discussion by interested parties. We did note and comment to City staff on the absence of any discussion of the aggregate water demands of the proposed annexation area. The Report observes that water will be allocated as each individual project is approved and that the City's Water Management Policy deals with non residential water demands through a 0.10 acre-foot community-wide non residential development water allocation as a component of the 0.35 acre-foot water allocation for each new residential unit. Nevertheless, City staff has indicated a more comprehensive analysis of projected water impacts for the entire annexation area would be provided in the context of subsequent phases of the annexation review process.

B. Validity of Assumptions: We believe the Applied Economics analysis is professionally rendered and incorporates no obvious biases. The analysis builds on two categories of assumptions: 1) assumptions regarding the impacts on City revenues and costs from any given pace and mix of development of the annexed property, and 2) assumptions regarding the projected pace and mix of development of the annexed property.

With respect to the former category of assumptions, Applied Economics has undertaken a comprehensive analysis of City revenue and expenditure line items to identify and quantify the likely fiscal impacts of the project. We believe the methodology followed and the conclusions reached regarding these projected revenue and expenditure impacts are reasonable based upon input provided by City staff. In addition, assumptions regarding rates of return on cash balances, borrowing rates, discount rates and future inflation rates are, on balance, conservative in light of current financial market conditions and market-based inflation forecasts.

Assumptions included in the latter category, namely those assumptions dealing with the projected pace and mix of future development of the subject property, are inherently more subjective in nature. For example, projections for build out patterns and annual occupancy rates have been provided by Cavan Development Group and cannot be subjected to independent verification. Alternative rates of build out and occupancy are considered in the Sensitivity Analysis section of the Report.

Even the "Gradual Growth Scenario" examined in this cost-benefit analysis would substantially overstate fiscal impacts if the local area population and economy were to enter a prolonged period of stagnation. Absent continued growth, build out and occupancy rates certainly would fall well below projections, and sales tax revenues generated from activity in the annexation area would be substantially offset by reduced sales tax revenues generated elsewhere in the City.

The assumed mix of commercial development also is relatively subjective. The study decomposes projected development of the annexation property into three broad categories of commercial activity: retail, office, and service. The assumed percentage division of land to be developed among these three commercial categories is referred to as the land use mix. Applied Economics adopts the same assumptions on land use mix – 40 percent retail, 36 percent office, and 24 percent service – as is used in the "Granite Dells Ranch Transportation Infrastructure Analysis" prepared by Lima & Associates in August 2008. As recognized in the Applied Economics Report, changes to the land use mix assumptions can have significant impacts on the projected fiscal impacts of the overall development. We believe relying on the Lima & Associates assumption was a

reasonable approach for Applied Economics to adopt. Nevertheless, we have no basis for assessing the likelihood the actual land use mix will approximate the land use mix assumed in these projections, and this represents an additional reason to view projected fiscal impacts as directional rather than precise forecasts.

C. Other Observations:

1. **Completion Risk:** Near term prospects for population and economic growth are tenuous at best, and one must at least consider the possibility that the next decade or more will witness a sharp break with historical patterns of growth. This situation is exacerbated by the current turmoil in domestic credit markets that has been reflected in a significant tightening in bank lending standards and a pronounced shortage of non-bank funding available for real estate development projects. If the current severe slowdown and unsettled credit market conditions were to persist, the City certainly could find itself having incurred substantial infrastructure costs for a project that has stalled or that has been aborted. And failure to complete this project also could leave the City, at least for a time, with an unsightly mess – making the White Spar and Lowe’s hill experiences pale by comparison. In light of the nearly unprecedented level of economic and demographic uncertainty in our area, we encourage the City to endeavor to minimize the extent of its exposure to both the financial and aesthetic aspects of project completion risk.

No one can accurately predict the future, particularly over a 25 year period. However decisions can be made to protect against the possibility of uncertain futures while pursuing stated goals. For those annexations requiring expenditure of current funds for infrastructure based upon estimates of future paybacks, protective measures can be taken prior to approval. One of these measures would be to require developers to provide a surety bond to the City to guarantee payment of City up-front costs if the proposed development were to fail or to be significantly delayed. A second measure the City could take would be to investigate the financial soundness including the banking arrangements of the developer prior to approval. In these uncertain times such requirements would represent a prudent approach for the expenditure of public funds.

2. **Up Front Investment and Payback:** The projections for this project show that the city would have to provide approximately \$2.3 million in infrastructure investment (p. 9, Figure 5) during the period 2009 through 2011. Based on the Report’s assumptions, this initial investment would not be recouped until 2014 (p. 11, Figure 7). While the long-term projected payback is substantial, the City Council must exercise its own judgment regarding whether the City can afford to make an investment of this magnitude at this time in the face of the fiscal constraints and uncertainties facing all Arizona governmental entities, including the City of Prescott.
3. **Consideration of Future Granite Dells Ranch Annexations:** The Report observes that “A succession of future, incremental annexations of Granite Dells Ranch (Cavan) property in proximity to State Route 89A/Granite Dells Parkway is anticipated. Since much of the major infrastructure will be built in the current (first) phase, updating the cost-benefit analysis at the time of each new annexation is recommended to afford a more complete picture of cumulative financial feasibility as the mix of land uses is refined.” We were not certain how to interpret this observation. If it is simply stating

that the quantitative assumptions underlying the analysis of the present annexation should be updated before using the Applied Economics models to assess the costs and benefits of future annexations, we heartily agree. However, these sentences could be read to suggest future annexations of Cavan owned property will be or should be evaluated by considering the cumulative economic and fiscal impacts of those annexations together with the annexation considered here. In other words, this language could be read to imply any subsequent "incremental annexation" of Cavan property will not be analyzed on a stand-alone basis. If the City anticipates giving weight to the projected net fiscal benefits of the current ("first phase") annexation when it considers subsequent annexations of portions of the Granite Dells Ranch, we believe it should make this policy explicit in the context of its review of the current annexation application.

Closing Comments:

We wish to thank the Mayor and Council of the City of Prescott for providing this opportunity to be of service.

Submitted by:

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