

# OVERLAY DISTRICT BALLOT INITIATIVE: FISCAL IMPACT ANALYSIS

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## CITY OF LAGUNA BEACH



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# 1.0 Executive Summary

Kosmont & Associates, Inc. doing business as Kosmont Companies (“Consultant” or “Kosmont”) is pleased to present this Fiscal Impact Analysis (“Analysis”) of the proposed Laguna Overlay District Ballot Initiative (“Initiative”)<sup>1</sup> for the City of Laguna Beach (“City” or “Laguna Beach”).

## Background

The Initiative would create an Overlay Zoning District that covers property within 750 feet from the centerline of either State Route 1 (Coast Highway) or State Route 133 (Laguna Canyon), which would impact over 50% of parcels within the City. The Initiative seeks to establish special requirements for specifically defined “Major Development Projects” and requires such Projects to be submitted to the voters for approval at a regular or special election, after the City Council has first approved a necessary zone change with a finding that the benefits of the Major Development Project outweigh the protections / requirements of the Overlay District.

Proponents are circulating voter signatures to place the Initiative on the November 2022 ballot. The City retained Kosmont to inform the City Council of certain potential near and long-term fiscal effects from the Initiative could be on the General Fund. For relevant context, and since it is difficult to project and estimate development projects that may be proposed in the future, Kosmont examined historical development activity for the past 20 years, with a focus on projects proposed in the past four years.

## Approach

For this Analysis, Kosmont performed the following tasks:

1. Reviewed the draft Initiative to understand conditions that would trigger a public vote
2. Toured City commercial corridors to identify potential development sites
3. Reviewed development proposals/projects in the past four years to identify projects that would likely have triggered a public vote
4. Looked at commercial development by decade since the 1920’s to consider historic development patterns
5. Interviewed Planning staff and City Attorney
6. Reviewed retail sales and hotel occupancy trends for past 10 years
7. Reviewed tourist visitation patterns using mobility data analytics that uses cell phone-based GPS information

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<sup>1</sup> See full Initiative at the following link:  
<https://www.lagunabeachcity.net/home/showpublisheddocument/9795/637723283630130000>

8. Reviewed General Fund revenue sources and tax rates (property tax, sales tax, hotel transient occupancy tax TOT, business license taxes) to development project impacts to the General Fund
9. Reviewed recently approved relatively small / retrofit type commercial projects (patio dining, rooftop dining, conversion of retail to café, remodeling of hotel rooms) that Initiative would likely classify as “Major Development Projects”
10. Reviewed similar voter approval measures passed in Southern California cities (Costa Mesa, Redondo Beach, Encinitas and Newport Beach) to provide relatively comparable circumstances and to gain a basic understanding of applied project thresholds and impacts on new development following passage

## Overview

The Analysis evaluates the potential fiscal impact for the City resulting from approval of the Initiative, which as proposed, within the prescribed geographic area, is likely to require voter approval of most projects that seek to redevelop existing commercial space, as well as new development projects. The Analysis examines the near term and long-term impact on the City General Fund that could be expected if the Initiative is passed into law. Because the Initiative has many diverse provisions, Kosmont focused on those provisions that are likely to have a predominant level of impact on fiscal revenue to the City.

The City has experienced relatively limited development in the past decade. A substantial proportion of the commercial structures in the Laguna Beach community were built over 40 to 50 years ago. In the past several years there are two examples of substantial hotel mixed use commercial projects with concept review completed (Museum Hotel and Cleo Hotel) that pursuant to the proposed Initiative, would have triggered a public vote. Based on Kosmont’s preliminary fiscal revenue analysis as related to the proposed concepts, it is estimated each project could generate as much as \$1 million per year to the General Fund. The fiscal revenues were derived from estimating the various taxes associated with retail, restaurant and hotel sales and room taxes, franchise taxes, and other business taxes. Kosmont has no basis upon which to predict the likelihood that either project would be approved with the Initiative.

Research of historical trends support the notion that when cities add voter approval requirements, they generally experience a dampening effect on commercial real estate projects and diminished growth levels in prospective tax revenues. It is inherently challenging for projects to achieve the public support needed for a “yes” vote on the ballot, and the time / cost / risk of going to a vote is often sufficient to discourage the private sector investment needed for projects to move forward through a ballot process.

The present-day timing of adding a substantial development requirement, such as a voter required approval for a specific project, is less than ideal. The commercial world is changing, with retail / hospitality facing a series of operational and marketing shifts and in a fluid and dynamic business environment including anticipated intermittent impacts of pandemic and related safety requirements, businesses need and benefit greatly from the capacity to adapt on a timely basis. The recent shift to outdoor dining and success for pick up and delivery are emblematic of the need for operational changes and flexibility.

It is challenging to precisely measure the fiscal impact of a voter approval process. Laguna Beach's fiscal health and sustainability, like many communities, relies at some level on the vitality of local restaurants, retailers and hotels, and their capacity to remain resilient and competitive. In this particularly fluid economy, impacted by pandemic-based operating limitations and an increasing preference to engage online instead of in-store, the expectation is that businesses will turnover or reset or reposition, which would require renovation and rehabilitation efforts in the future. Because the Initiative's election thresholds likely apply to most renovations / small expansions / changes of use, it may make it harder for owners / private investment to act efficiently and with certainty. Other communities with a voter approval process have generally set the entitlement trigger thresholds at the General Plan or zone change level, which typically affect larger developments with more substantial revenue and community impacts. As a practical result, these voter approval process in certain cases enable smaller / retrofit type projects to avoid cost / time / risk / uncertainty related to a voter election.

### City General Fund

For FY 2021-22, the City General Fund revenues are projected to exceed \$72.6 million, (rounded) with property taxes representing 58% of the total, followed by hotel transient occupancy taxes at 10% and sales taxes at 8%, as shown in Figure 1.1 table below.

**Figure 1.1 General Fund Revenues**

Laguna Beach General Fund Revenues			
Category	2021/22 Budget	% of Total	
Property Taxes	\$ 42,173,000	58%	
Sales Taxes	5,571,000	8%	
Transient Occupancy Taxes	7,350,000	10%	
Business License taxes	945,000	1%	
Other Taxes	1,160,000	2%	
Community Development Fees	3,136,000	4%	
Charge for Services	7,548,000	10%	
License & Permits	1,320,000	2%	
Money & Property/Other	3,445,000	5%	
<b>Total</b>	<b>\$ 72,648,000</b>	<b>100%</b>	

Source: FY 2021-22 City Budget  
Totals may not add due to rounding

Within the property tax category, the City Adopted Budget for FY 2021-22 estimates 90% of the revenues comes from residential property.<sup>2</sup> Combining the \$4 million from 10% property tax share for commercial property with hotel TOT, retail sales taxes and business taxes, ~25% of General Fund revenues comes from commercial office, retail, and hotel businesses.

Over the past 10 years, property taxes have grown by approximately 50%, or ~4% per year, however sales tax and hotel TOT have grown at a faster pace of almost 100%.

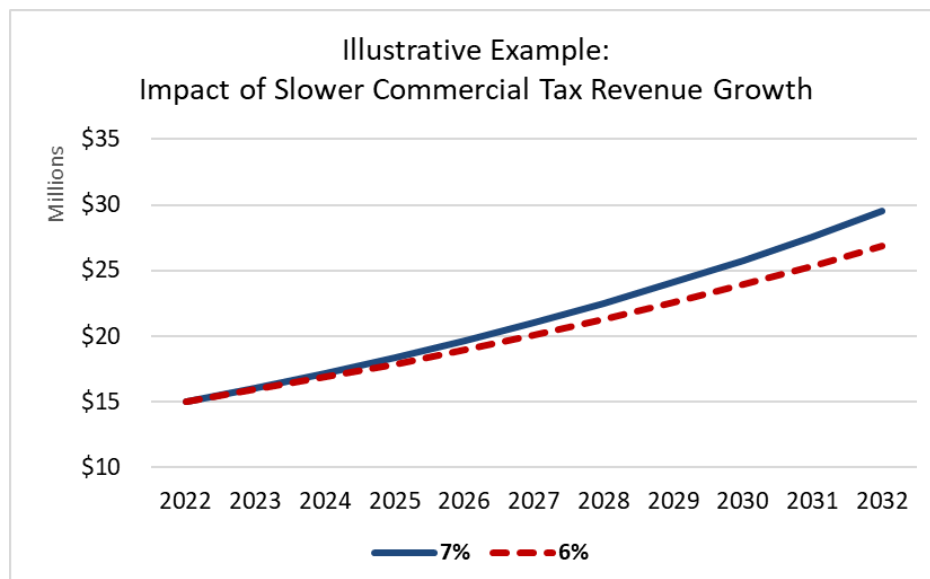
<sup>2</sup> City of Laguna Beach, Adopted Budget FY 2021-22, Page 4 of 242



As stated in the City Budget for FY 2021-22, the commercial tax revenues (sales, business license and hotel taxes) were approximately \$15 million and had grown at a 7% annual compound rate in past decade, with no new major development projects. If one assumes that a similar growth rate is likely for the next 10 years, without the voter approval requirements, the General Fund could grow by \$14 million to a total of approximately \$29.5 million per year.

One way to illustrate the potential financial impact of reduced commercial development activity would be to calculate the cumulative effect of a slightly slower growth rate. For example, a 6% annual growth rate (e.g., loss of 1% due to Initiative) for the 10-year period would result in a \$11.4 million gain in 2031-32 commercial tax revenues for a total annual amount of \$26.9 million.

Below is a graph showing that just a 1% slower growth rate results in a loss of \$2.6 million for FY 2032, compared to the historic baseline growth rate.



<i><b>Illustrative Example of Slower Growth Rate</b></i>	<b>Est. 2032 Commercial Tax Revenue</b>		<b>Est. Cumulative Commercial Tax Revenue (2022-2032)</b>
7% Rate	\$	29,507,000	\$ 236,755,000
6% Rate	\$	26,861,000	\$ 224,569,000
Difference	\$	(2,646,000)	\$ (12,186,000)

Source: Kosmont Companies

### Case Studies - Similar Initiatives

Kosmont's review of locally approved initiatives that require voter approval indicates that since 2000, the following Southern California coastal communities have passed relatively similar or relevant procedural approaches:

- Newport Beach Measure S
- Costa Mesa Measure Y
- Redondo Beach Measure DD
- Encinitas Proposition A

These initiatives have varying thresholds for requiring a public vote of a development project, but generally require voter approval for projects that need a General Plan or zoning amendment(s), which represent thresholds that in the hierarchy of land use and zoning approvals, are fundamentally higher than those proposed in the Laguna Beach Initiative. There were certain development projects built / proposed in various of the example cities that were able to proceed without a public vote because the projects did not exceed the thresholds that required voter approval. Within these communities, based on information Kosmont uncovered, projects submitted for a public vote after passage of the vote requirement did not achieve voter approval.

### **Laguna Overlay Initiative: Impact on Recent Development Projects/Activity**

City Planning staff's analysis of development proposals submitted in the past four years indicates that a majority of applications would have triggered the voter approval requirements per the Initiative. The approved projects include:

- Remodel of 24-room Coast Inn
- Remodel and 25-room expansion of Pacific Edge
- Remodel of White House restaurant
- Remodel and expansion of 34-room La Casa del Camino hotel
- Conversion of small retail shops to café
- Addition of outdoor dining areas at ZPizza
- Addition of rooftop dining area at Skyloft

Projects that are still in the approval process include Cleo Hotel and the Museum Hotel, which could add as many as 200 new hotel rooms and could generate \$2 million in gross tax revenues (subject to the effect of competition to other hotels).

Based on provisions of the Initiative, the two proposed hotel projects would likely trigger "cumulative effect" provisions that could cause even **minor** development proposals in the downtown area to require voter approval during the timeframe that the two projects are in the entitlement process, or for as long as the next 8 years if those two projects are built.

### **Summary**

The Initiative, if passed, will likely have a noticeable negative fiscal impact to City General Fund revenues levels over the next decade and beyond. Kosmont's preliminary analysis of the two dozen commercial projects submitted for approval in the past four years that would likely qualify as "Major Developments" indicates potential annual gross fiscal revenues of almost \$3 million from property taxes, sales tax, and hotel taxes by 2026-27, assuming normal entitlement and construction timeframes. Collaterally, there will be increases in municipal service costs as well. While a detailed analysis of fiscal costs was not part of the Kosmont scope of work, Kosmont did provide an illustration of potential increased public safety costs (See Appendix Section 7.1), which is one of the key variable municipal service costs in determining net fiscal impacts.

To enable the City to consider potential impacts from the proposed Initiative, Kosmont prepared the analysis of potential fiscal revenue impact, should the Initiative become law. Research indicates that the majority of Southern California development project proposals that have required voter approval have not moved forward (and that in general, voter approval requirements can often discourage development projects from being proposed in the first place). By way of illustration, Kosmont estimated a 10% to 30% range of projects as approved by voters based on those submitted in the past four years, as a proxy for future development. Kosmont also assumes a reduction in the General Fund impact of 25% from competition to other businesses / existing commercial activity also known as “cannibalization”.

Based on the foregoing, Kosmont estimates that the potential impact to General Fund revenues from the loss of a majority of development proposals in a 4–5-year period ranges from \$1.5 to \$2 million per year, or 2% to 3% of total General Fund revenues.

#### General Fund Revenue Impact – Recent Proposed Projects

				10% Voter Approval	30% Voter Approval
	Loss of Gross Tax Revenues			(\$2,700,000)	(\$2,100,000)
	25% Cannibalization			<u>675,000</u>	<u>525,000</u>
	<b>Annual GF Impact (Loss)</b>			<b>(\$2,025,000)</b>	<b>(\$1,575,000)</b>

Source; Kosmont Companies

These impacts are cumulative, meaning that the longer the voter requirement remains in effect, the greater the annual loss. For example, after 10 years, the estimated loss from the projects that would have been proposed in the first five years, combined with the ongoing additional loss from a similar level of unapproved or dissuaded development projects in years 6-10, could ultimately increase the cumulative loss to \$3 – \$4 million per year.

#### Other Possible Impacts

Approval of the Initiative could also result in the following:

- Discouraging replacement of outdated facilities with modern commercial projects
- Discouraging renovation / retrofit of historic buildings that do not meet current code standards
- Discouraging development of affordable housing (to meet RHNA targets)

*The analyses, projections, assumptions, and any examples presented herein are for illustrative purposes and are not a guarantee of actual and/or future results. Actual results may differ from those expressed in this Analysis, as results are difficult to predict as a function of market conditions, natural disasters, pandemics, significant economic impacts, legislation, and administrative actions.*



## 2.0 Key Provisions of Ballot Initiative

### 2.1 Ordinance Creating Overlay Zoning District

The Initiative – unofficially named Beautiful Laguna Overlay Zoning District – is currently gathering signatures to qualify as a ballot initiative for November 2022. The proposed zoning district encompasses land area within 750 feet of the centerline of Pacific Coast Highway (SR 1) or Laguna Canyon Road (SR 133). The Initiative has special requirements for any Major Development Project, requiring voter approval at a regular or special election after City Council has approved a necessary zone change removing subject property from the requirement of the Overlay District. See full Initiative at the following link: <https://www.lagunabeachcity.net/home/showpublisheddocument/9795/637723283630130000>

### 2.2 Major Development Project

A Major Development Project is defined by the Initiative as any improvements or change of use that impacts density or traffic through one or more of the following:

1. Exceeds 22,000 SF of gross floor area
2. Causes an increase of 200 or more Average Daily Trips (“ADT”)
3. Provides fewer than “reasonably necessary number of spaces” as defined
4. Exceeds height standards (e.g. 12 feet in downtown Specific Plan area)
5. Combines two or more parcels that create a single parcel of 7,500 SF, or 6,000 SF within the Downtown Specific Plan area (with some exceptions)
6. Causes a cumulative effect of more than 800 ADTs or 88,000 SF of gross floor area, if combined with projects located within ½ mile radius that have:
  - a. been submitted for approval or
  - b. granted building permit in last 8 years and
  - c. not withdrawn or terminated

The following development projects would be exempt:

- Single family homes
- Multi-family of 9 units or less
- 100% affordable projects
- Schools, hospitals, churches, museums
- Replacement of buildings damaged by a “disaster”
- Minor Modification of a Major Development Project which does not:
  - Increase height,
  - Increase floor area by more than 5%,
  - Increase traffic
  - Worsen parking

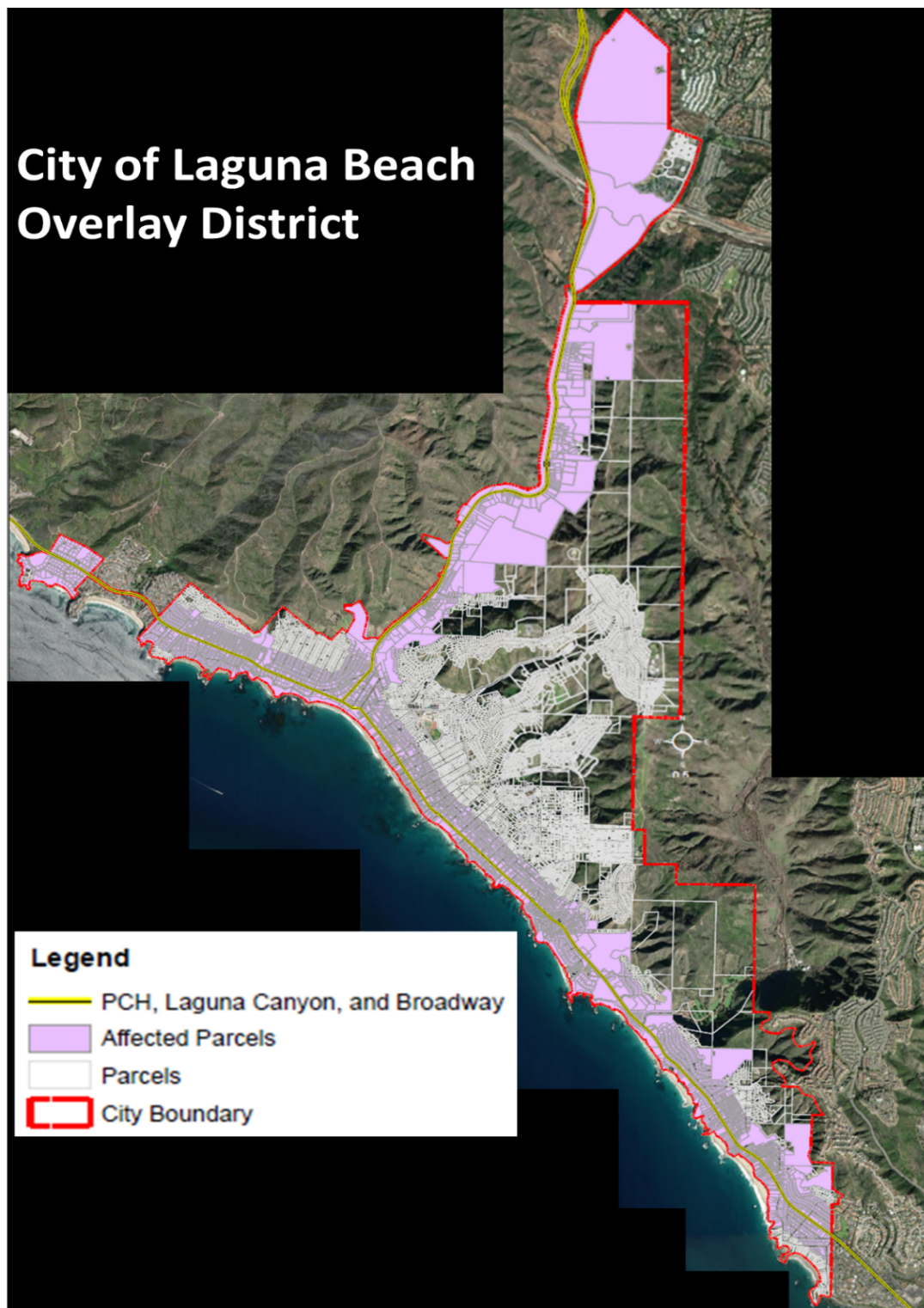
The maps on the following pages show the City boundaries and impacted areas of the Initiative.

**Figure 2.1 Regional Map of Laguna Beach Area**



Source: ESRI Business Analyst Online

Figure 2.2 Map of Proposed Overlay District



Source: City of Laguna Beach

## 3.0 Economic & Market Overview

### Regional Trends

Development activity in Orange County has generally been robust over the past decade. Office development has remained strong – particularly in areas such as Irvine and Costa Mesa – but faces challenges as work trends shift toward work-from-home. The Orange County hotel market is a historically high performer, with demand driven by both tourism / leisure as well as business travelers in the tech, financial, and biotech industries; major developments have been occurring in Anaheim and Irvine, as well as coastal projects in Newport Beach and Huntington Beach. The residential market in Southern California is particularly robust, due to the high demand for housing and low housing production in recent decades, with both the single-family and multifamily markets seeing soaring prices and low vacancy. Retail has historically been strong but more recently been heavily impacted by the consumer shift to e-commerce; demand is shifting away from many regional shopping malls and other traditional retail centers, with strength in developments centered around essential and experiential businesses.

The consumer world is changing, with retail and hotels experiencing major operational and customer preference changes; it is expected that businesses and property owners will increasingly need flexibility to periodically and timely adapt to changing consumer demands. To the extent that voter approval adds an obstacle for both large new projects as well as smaller renovations / retrofit / adaptive reuse efforts, it makes it harder for local businesses to remain profitable and maintain a competitive in-store platform.

### Regional Visitors & Tourism

Laguna Beach draws a large number of visitors from across Orange County, Southern California, and beyond. These visitors and tourists bring a substantial amount of economic activity to the community via shopping, dining, and lodging. Kosmont utilized Placer.ai, a mobile analytics artificial intelligence tool that offers insights into visitor foot traffic, to better understand where the visitors live who come to the commercial areas in Laguna Beach.<sup>3</sup>

According to Placer.ai data:

- Approximately 22% of visits to the downtown are from home locations less than 5 miles,
- Regional visitors (those with homes between 5 – 50 miles away) account for 45% of visits,
- The remaining 33% of visits coming from home locations greater than 50 miles away.

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<sup>3</sup> Placer.ai is a mobility data platform that tracks movement of over 30 million people in the U.S. via anonymized mobile app data. This information can reveal visitation trends to/from retailers and other places, providing insight into visit performance and characteristics of consumers. Visitor data was culled for both 2019 and 2021 for the commercial area of Laguna Beach generally bounded by the triangle formed by 3<sup>rd</sup> Street, Cliff Drive, and the beach.

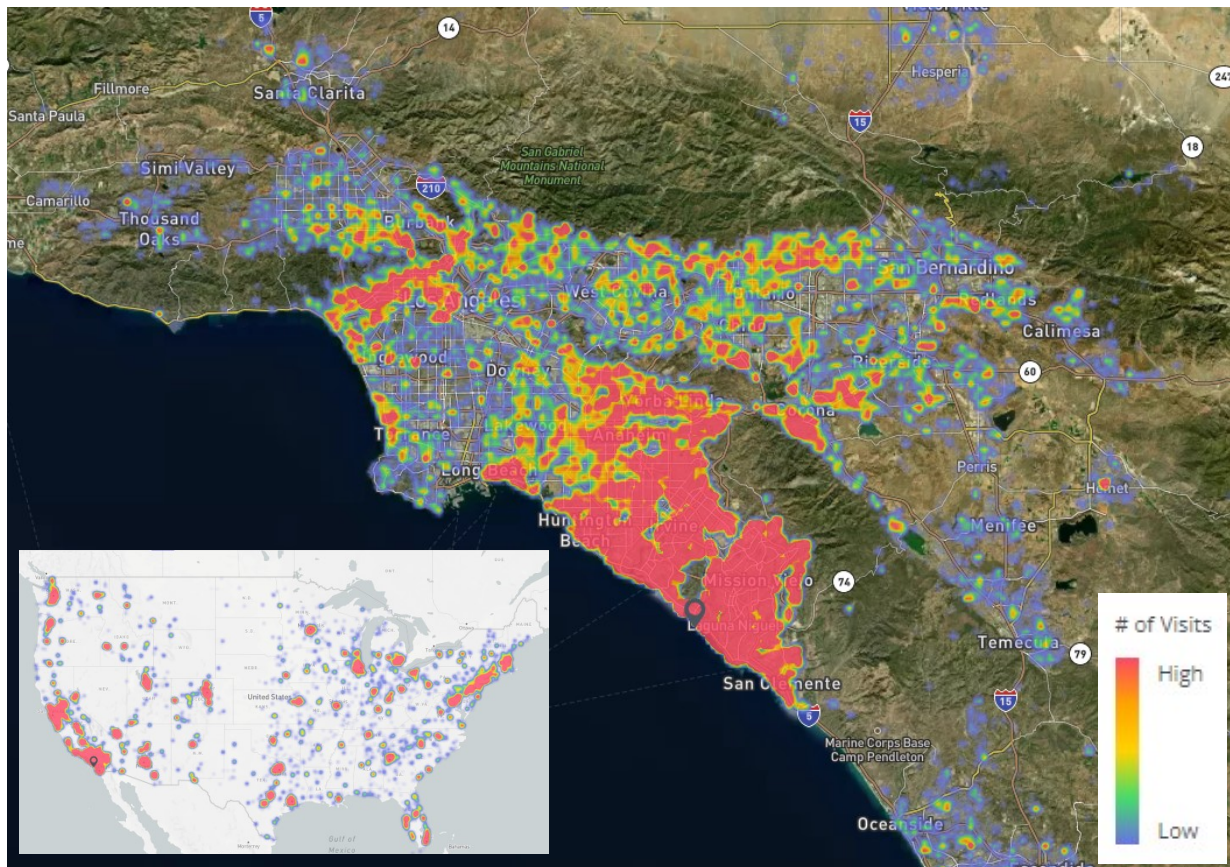


Visit Laguna estimates that these regional tourist visitors account for 6 million annual visits to the downtown commercial area. Figure 3.1 on the next page shows the significant appeal of downtown Laguna Beach, across the United States.

These regional visitors and tourists come from relatively high-income areas. According to Placer.ai, the average household income for regional / distant visitors is \$124,000.

According to Placer.ai, favorite locations for these regional and distant visitors include (in no order) Main Beach, The Greeters Corner, The Cliff, Carmelita's, Skyloft, The Deck, The Lumberyard, Las Brisas, The White House, Montage Laguna Beach, Pacific Edge Hotel, Inn at Laguna Beach, and Surf and Sand Resort.

**Figure 3.1**  
**Tourist Home Location Heatmap**



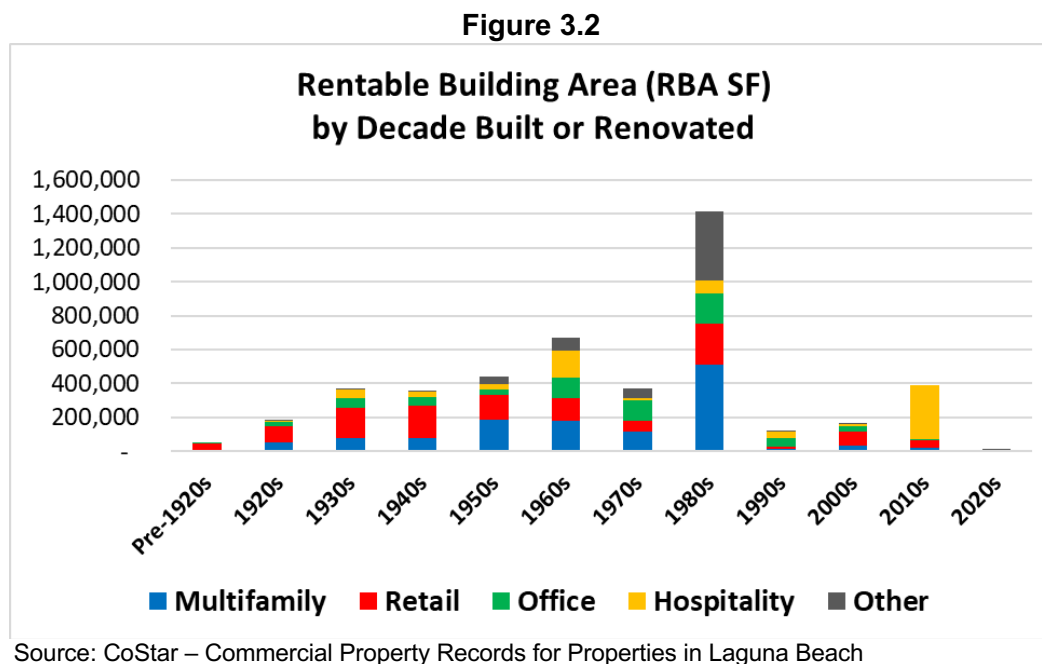
Source: PlacerAI

## Commercial Structures

A substantial proportion of the commercial structures in the Laguna Beach community were built over 50 years ago. Based on commercial building data provided by CoStar, only ~15% of the commercial building area in the City (an estimated 686,000 SF of building area) was built within

the past 30 years, indicating potential need for major rehabilitation and retrofit in the next 10-20 years.

Figure 3.2 on following page shows the development patterns by land use for each decade.



As the most significant tax generator, hotel properties are indicative of this pattern. According to CoStar, approximately 57% of the City's 1,359 hotel rooms are in properties that have been built (or substantially renovated) in the past 50 years. For more information, refer to the detailed hotel property data in Appendix Table 7.2

**Figure 3.3**  
*Construction By Land Use Type and Decade*

	Multifamily	Retail	Office	Hospitality	Other	TOTAL	
<b>Pre-1920s</b>	8,000	37,000	2,000			47,000	1.0%
<b>1920s</b>	54,000	93,000	29,000	7,000	3,000	186,000	4.1%
<b>1930s</b>	80,000	174,000	62,000	48,000	10,000	373,000	8.2%
<b>1940s</b>	78,000	188,000	51,000	34,000		352,000	7.7%
<b>1950s</b>	189,000	141,000	35,000	30,000	48,000	443,000	9.7%
<b>1960s</b>	182,000	129,000	120,000	161,000	79,000	672,000	14.8%
<b>1970s</b>	114,000	64,000	121,000	15,000	55,000	369,000	8.1%
<b>1980s</b>	509,000	240,000	183,000	72,000	410,000	1,416,000	31.2%
<b>1990s</b>	15,000	14,000	48,000	43,000	1,000	120,000	2.6%



<b>2000s</b>	32,000	82,000	34,000	14,000	4,000	167,000	3.7%
<b>2010s</b>	24,000	43,000	7,000	313,000	-	388,000	8.5%
<b>2020s</b>	5,000	-	5,000	-	3,000	12,000	0.3%

Source: CoStar – Commercial Property Records for Properties in Laguna Beach

### *Recent Development Activity*

Despite the strong demand and development activity in Orange County, development activity in the City has been limited in the past two decades, with only a few development projects, such as:

- **20000 Laguna Canyon Road:** 4,500+ SF artist live/workspace across 4 units, expected to be completed in early 2022
- **Montage Hotel:** 258-room luxury hotel opened in 2003 and renovated in 2019
- **Laguna Canyon Place:** 18,500 SF of office across two buildings, built 2008-2009
- **1833 S Pacific Coast Hwy:** 9,000+ SF of storefront Retail / Office, built in 2006
- **Alice Court:** 27-unit apartment building, built in 2002

Examples of site renovations / conversions include The Hive (a renovation of the Festival Center retail), various hotel renovations (Casa Laguna Hotel & Spa, Pacific Edge, Inn at Laguna Beach), and The Heisler Building (retail / restaurant built in 1931 and renovated in 2015).

There are few undeveloped opportunity sites in the City, particularly along the major corridors that feature commercial development (CA-1 and CA-133); most recent (and future) development projects will either require the renovation of an existing use or demolition / conversion of a site to new uses.

### *Projects in Process*

Several substantial projects that are in the early stages of planning would likely trigger a vote under the requirements of the Initiative. Laguna Creative Ventures, a local development firm, has several projects in the early stages of planning, including the Museum Hotel (a 116-room hotel with restaurants and retail) and The Cleo Project (a 112-room hotel with restaurant and retail).

Aside from these large hotel/commercial projects currently under review in the planning process, the Initiative would also apply to a number of relatively smaller projects that meet at least one of the thresholds to qualify as a “Major Development Project”.

City Planning staff prepared a list of approximately two dozen projects that have been submitted in past four years and that would likely trigger a vote under the Initiative for its defined “Major Development” project. Those properties are listed together with the parameters that could trigger a public vote in Figure 3.4 on the following page.

**Figure 3.4**  
*Potential “Major Development” proposals submitted  
between Sept. 2017 and Sept 2021  
(Additional projects may have been submitted)*

Address	Project Name / Description	Major Development Project Trigger
700 S. Coast Hwy.	Ralphs - outdoor display	Intensification of a legal, nonconforming property that does not satisfy the initiative's parking requirement (4 spaces per 1000SF).
331 N. Coast Hwy.	Royal Hawaiian - outdoor dining	Intensification of a legal, nonconforming property would fail initiative's parking requirement (1 space per 100 SF or 1 space per 3 seats). Consistent with the Parking Code, Project was only required to park the outdoor dining area,
2894 S. Coast Hwy.	The Drake – restaurant expansion	Reliance on grandfathered parking credits.
1200 S. Coast Hwy.	The Pottery Place – additions	Reliance on historic parking reduction incentive.
400-424 S. Coast Hwy.	Skyloft - rooftop furnishings and modifications to conditions of approval.	Exceeding height limit with rooftop furnishings.
1401 S. Coast Hwy.	Coast Inn - Remodel of 24-rm. hotel and existing restaurant.	Height variance to restore historic features.
300-340 S. Coast Hwy.	Remodel of the former White House restaurant with a new outdoor dining area, and new rooftop mechanical equipment.	Two thresholds met: (1) Reliance on historic parking reduction incentive and grandfathered parking credits; and (2) height variance for new rooftop mechanical equipment.
658 S. Coast Hwy.	Reconstructing a single-family residence on a mixed-use site.	Reliance on historic parking reduction incentive and grandfathered parking credits. Does not qualify for an exemption from "Major Development Project" because the site is mixed-use with highway-
305 Forest Ave., Ste. 103	Harmony Tea Bar – Convert retail to café.	Reliance on historic parking reduction incentive and grandfathered parking credits.
859 Laguna Canyon Road	Laguna Beach Beer Company - Addition and new outdoor dining	Parking required only for the intensified area; property and tenant space remain legal, nonconforming with respect to the parking requirements.
477 Forest Ave.	Slice - Convert retail to restaurant.	Reliance on historic parking reduction incentive.
477 Forest Ave.	Slice - New outdoor dining area.	Reliance on historic parking reduction incentive.
30822 Coast Hwy.	ZPizza - New outdoor dining area.	Reliance on sidewalk café parking credits.
213 Ocean Ave.	Hennessey's Tavern - New first floor outdoor dining area and new second floor dining deck.	Reliance on sidewalk café parking credits.
1391 S. Coast Hwy.	Coast Liquor and Olympic Cottage - Historic restoration and intensification of use.	Reliance on historic parking reduction incentive, grandfathered parking credits, and sidewalk café parking credits.
357 S. Coast Hwy.	Convert retail/office to restaurant with a historic rehabilitation.	Reliance on historic parking reduction incentive, grandfathered parking credits, and sidewalk café parking credits.
400 S. Coast Hwy.	Skyloft - New elevator access for rooftop deck.	Height variance for a new elevator enclosure at the existing rooftop deck
647 S. Coast Hwy. and 610-668 Sleepy Hollow Ln.	Pacific Edge - Remodel expansion of an existing hotel with restaurants and conference rooms	Two thresholds met: (1) the 25 new hotel rooms, 14 additional seats at the existing restaurants, and creation of a new 63-seat café are anticipated to generate 245 net new daily trips; and (2) a new elevator to meet a height variance.

Source: City of Laguna Beach Planning Department

## 4.0 Fiscal Impact Methodology

The Analysis is based on information provided by the City, Orange County Auditor-Controller's office, California Department of Finance ("DOF"), California Board of Equalization ("BOE"), U.S. Census, U.S. Bureau of Labor Statistics ("BLS"), ESRI, Smith Travel Research ("STR").

### 4.1 General Assumptions

Unless otherwise noted, the subsequent analysis maintains the following assumptions.

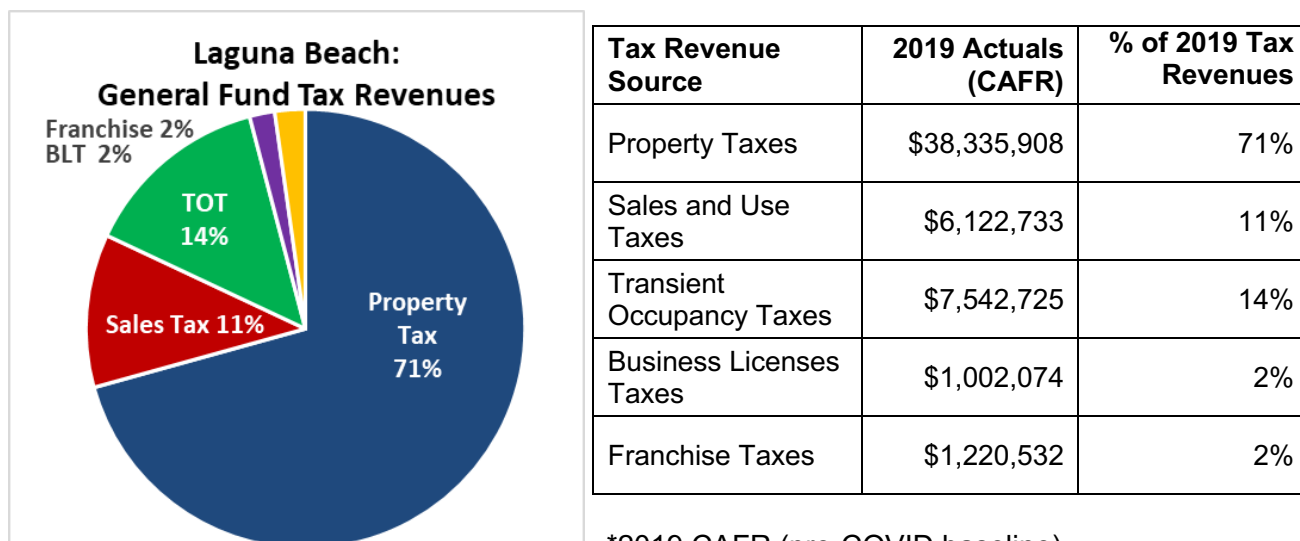
- Dollar amounts are expressed in 2021 dollars.
- Fiscal impacts are estimated at full build-out and stabilized occupancy.
- Tax revenues are based on operations and the spending from on-site employment.

### 4.2 Fiscal Revenue

As identified herein, the City has multiple primary General Fund revenue sources that may be impacted by the requirements placed on new development and use conversions by the proposed Initiative.

#### *General Fund Tax Revenue Sources*

Based on the 2019 CAFR\*, the City collected tax revenues from the following sources, with property taxes accounting for 71% of General Fund tax revenues.



\*2019 CAFR (pre-COVID baseline)

### *Property Tax*

Secured property tax revenues are based on the assessed value of development projects upon full build-out and the applicable property tax rates for the City (see Exhibit 5.2.1). Laguna Beach receives approximately 24% of the 1% General Levy; this means that every \$1 million dollars of assessed property value results in ~\$2,400 in annual General Fund property tax revenues. The Initiative may discourage or otherwise reduce property development projects and renovations, resulting in loss of potential future tax revenues.

### *Property Tax In-Lieu of VLF*

Prior to 2004, a percentage of State motor vehicle license fees (VLF) were distributed to cities and counties. In 2005, the State of California instituted a revenue swap, guaranteeing that municipalities and counties receive a distribution equal to the VLF collected the prior year, plus a percentage equal to the annual increase in assessed value. This increases the City's apportionment by an amount equal to approximate 8% share of the basic tax levy, to the extent projects are not approved or implemented this would reflect a loss of \$192 in tax revenues for every \$1 million dollars of lost assessed value.

### *Sales Tax (On-Site / Direct)*

In the State of California each City collects sales tax on taxable sales of 1.0%. The majority of sales tax is collected by retailer at the point of sale, but with tremendous growth in online sales which based on growth history, are approaching 25% of total sales, the State and County collect use taxes from the online retailers and reallocate back to the cities on a pro rata basis. The top 25 sales tax producers account for 44% of total sales tax revenue in the City; 54% of sales tax revenue is attributable to restaurant sales.<sup>4</sup>

The Initiative may discourage retail development projects or conversions from no/low-sales tax uses to high-sales tax uses (e.g., by making it harder to convert shop space to restaurant space). Small retailers of 1,000 to 2,000 square feet vary significantly in the amount of sales tax they generate. Based on taxable sales of \$250-\$300 per square foot it would be \$3,000 to \$5,000 annually, while fast casual restaurants can yield taxable sales of \$500 to \$1,000 per square foot, or \$10,000 – \$20,000 in annual tax revenues.

### *Sales Tax (Off-Site)*

In addition to the onsite sales at each retail facility, office and other employees spend 20% to 30% of their annual pretax payroll income on goods and services in the local market areas where they work and live, and thus will generate off-site sales taxes within the City.

Hotel guests also spend at restaurants and other local businesses, resulting in sales tax revenues captured from nonresidents; a hypothetical 100-room hotel with a daily spend of \$100 / room at 70% occupancy would generate \$25,000 in sales tax revenues for the General Fund.

In a coastal location, market rate multi-family housing typically attracts new households with primarily above average income levels that will spend \$20,000 to \$50,000 per year in restaurants

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<sup>4</sup> City of Laguna Beach, FY2022 Adopted Budget, Page 4 (Page 16 of PDF)

and retail shops. A 100-unit project could help generate \$30,000 in annual revenue to General Fund.

### *Transient Occupancy Tax*

Transient Occupancy Taxes (TOT) are applied to the room cost of a hotel, inn, motel, tourist home, or other lodging facility charged at a rate of 12%. The General Fund receives 10% of the room charge, while the Measure LL fund that was established in 2016 receives 2% of room charges. Hotels can generate a substantial amount of tax revenues; a hypothetical 100-room luxury hotel charging \$400 / night at 70% occupancy could generate close to \$1 million in gross TOT revenues for the General Fund.

### *Business Taxes*

The City collects business taxes from individuals and firms that conduct business in the City. Fees can range from flat charges of \$60 to \$360, to formulas based on vehicles employees and gross receipts fee of \$0.44 per \$1,000 to \$1.10 per \$1,000 of revenue.

### *Building Permits*

The City collects various development and administrative fees related to new construction.

### *Disclaimer:*

*The analyses, projections, assumptions and any examples presented herein are for illustrative purposes and are not a guarantee of actual and/or future results. Actual results may differ from those expressed in this Analysis, as results are difficult to predict as a function of market conditions, natural disasters, pandemics, significant economic impacts, legislation and administrative actions.*

## 5.0 Case Study Research

Kosmont's review of dozens of statewide initiatives found several similar voter initiatives that have been passed since 2000. It is difficult to precisely measure the fiscal impact of a voter approval process. Kosmont found that other initiatives generally required General Plan or zoning changes, while Laguna Beach has more onerous triggers (square footage, traffic, parking, height limits) that can also apply to small projects.

The following cities in Southern California were selected as the most representative examples of successful ballot initiatives that required voter approval of new development projects if they did not meet certain standards. For each city, Kosmont examined the following:

- Similarity to Laguna Beach provisions
- Success/failure of projects subject to voter approvals
- Other development activity occurring in the City

### 5.1 Newport Beach – Measure S

#### *Similarity of Provisions / Thresholds*

Measure S was approved by Newport Beach voters in November 2000. It requires voter approval of General Plan amendments for certain projects:

1. More than 100 trips in AM or PM peak hour
2. More than 100 dwelling units
3. More than 40,000 SF of gross building area

#### *Success / Failure of Voter Approvals*

In the three years following passage, there were three developer proposals that qualified for voter approval. All three were defeated and there have been no additional attempts by developers to seek any General Plan amendments. However, in 2006 the City of Newport Beach submitted a new General Plan to voters who approved it. The key provision of the new General Plan redesignated land planned for 500,000 square feet of future office uses into land designated for 2,200 future residential units. In 2014, voters rejected a city backed Measure Y that was designed to transfer future housing units in Pelican Hill area to Newport Center.

#### *Other Recent Development Activity in the City*

There have been some development projects built in Newport Beach since the passage in 2000, including retail, hotel, and multi-family residential projects, as they did not require a General Plan amendment.



## 5.2 Costa Mesa - Measure Y

### *Similarity of Provisions / Thresholds*

Measure Y was approved by voters in November 2016. It required voter approval for any change in land use to the General Plan, including modifications to the Zoning Ordinance. Significant change is defined as a project that:

- increases traffic by more than 200 average daily trips
- produces more than 40 dwelling units
- produces more than 10,000 square feet of commercial

### *Success / Failure of Voter Approvals*

According to Councilmember Marr in a May 27, 2020, *Daily Pilot* article, Measure Y has helped defeat several significant hotel projects that would have generated substantial tax revenues.<sup>5</sup> Additionally, in a May 20, 2020 *Daily Pilot* article, Costa Mesa's Economic and Development Director is quoted as telling the City Council that "a variety of development projects have not been pursued, because the projects would be subject to Measure Y," largely due to the "extended time needed to process an application and the requisite uncertainty associated with a ballot measure."<sup>6</sup>

### *Other Recent Development Activity in the City*

The City of Costa Mesa is currently processing one major development project called One Metro West, which would add over 1,000 housing units and significant office and retail space. If it continues through the entitlement process, it will require voter approval per Measure Y.

While Measure Y as observed by city representatives, had a negative impact on some development projects, it has not completely halted development in the City. The table below highlights non-voter approved projects that resulted in the construction of over 700,000 SF of commercial space and over 1,000 apartments.

**Costa Mesa Projects Not Requiring Public Vote**

Property Name	Address	Type	RBA	Apt Units	Construction Begin	Year Built
The Press	1375 Sunflower Dr	Office	449,206		Jul 2019	2022
Halcyon House	565 Anton Blvd	Multifamily	350,000	393	Jul 2020	2022
	2277 Harbor Blvd	Multifamily	230,000	200	Mar 2021	2022
Finish Line Auto Club	3080 Airway Ave	Industrial	78,738		Jan 2020	2021
Vans HQ Expansion	1588 S Coast Dr	Office	91,032		Mar 2020	2021
Symphony Towers	585-595 Anton Blvd		241,331	484	Jan 2020	2021
The Harbour at OCC	1369 Adams Ave	Student	350,000	464		2020

Source: CoStar

<sup>5</sup> "Costa Mesa's Measure Y won't go before voters for changes, but could be part of future talks on growth," Los Angeles Times - Daily Pilot, May 27, 2020

<sup>6</sup> "Costa Mesa ponders changing 2 voter-backed measures to accommodate growth, housing," Los Angeles Times – Daily Pilot, May 20, 2020

### **5.3 Redondo Beach - Measure DD**

#### *Similarity of Provisions / Thresholds*

Measure DD was approved by voters in November 2008. It required voter approval for any major change in land use to the General Plan, including Local Coastal Element and Zoning Ordinance. Significant change was defined as a project that:

- increases traffic by more 150 peak hour trips
- produces more than 25 dwelling units
- produces more than 40,000 square feet of commercial

#### *Success / Failure of Voter Approvals*

In order to improve the waterfront including several major infrastructure improvements to the city-owned Redondo Beach Harbor, the City of Redondo Beach sought to attract a developer who could fund the improvements in exchange for 400,000 square feet of commercial development rights in the Harbor area. In response to the proposed project, Measure G was placed on the ballot in November 2010 and it was approved. However, several years later, after a development proposal that was received in compliance with Measure G went through an extensive formal design process, a local citizen's group collected signatures to place yet another initiative to substantially limit development in the Harbor area. That initiative passed and the developer ultimately withdrew from the project.

#### *Other Recent Development Activity in the City*

There have been some development projects built in Redondo Beach since 2008 that did not require General Plan amendment.

### **5.4 Encinitas Proposition A**

#### *Similarity of Provisions / Thresholds*

Proposition A was approved by voters in June 2013. It requires voter approval of any major amendments to a Planning Policy Document (General Plan, Zoning Code, or Specific Plans or Development Agreements such as:

1. Changes in zone types (i.e., residential to non-residential)
2. Increases maximum allowable commercial square footage
3. Increase dwelling units
4. Increases in building height above two stories or 30 feet
5. Increase in number of separate parcels created
6. Anything that repeals any planning document

#### *Success / Failure of Voter Approvals*

According to an interview with City of Encinitas planning staff, there have been no developer requests for zoning or other building variances since it passed. The city did submit to voters a new Housing Element that increased housing density for key sites in order to meet affordable housing mandates from RHNA. The Housing Element was defeated by the voters.

#### *Other Recent Development Activity in the City*

There have been some development projects built in Encinitas since 2013, consistent with General Plan and zoning, including minor retail developments, a hotel, and a few multi-family residential projects.

### **5.5 Case Study Summary**

Several other coastal cities in Southern California have voter approval requirements for major development projects due to recent ballot initiatives. These cities generally set a high threshold for requiring voter approval — projects that need General Plan or zoning changes and meet other criteria. Projects seeking voter approval in these cities have not been successful. However, each city has seen some projects be approved and developed because those projects are outside the parameters of the respective initiatives.

## 6.0 Findings

### 6.1 Laguna Ballot Initiative

The Initiative will most likely impose voter approval requirements on a broad range of development projects (commercial and multi-family residential). The traffic and parking thresholds will have an impact on the feasibility and implementation timing of new or expanded facilities.

Kosmont's review of staff's analysis of recent projects submitted to City indicates that a majority of commercial applications, even for properties as small as a 500 square foot patio expansion, would likely trigger the voter approval requirements.

Kosmont's research on other cities voter initiatives found that voter approval requirements add a significant element of risk and uncertainty that can discourage investment in new projects, as well as rehabilitation of underutilized or blighted properties. The development process contains many levels of risk without imposing an expensive and time-consuming voter approval process. The experience of projects actually subjected to a vote pursuant to local voter ballots has by and large resulted in rejection.

The proposed Laguna Beach voter approval will require the private sector to make substantial investment in design, environmental clearance and other required City approval procedures and submittals before the Project would be eligible to appear on a ballot. It is expected that the voter approval requirement can add four months to 27 months to the process, depending. This additional time can significantly increase carrying costs such as land loan interest, property taxes and overhead, in addition to the anticipated election costs (can be \$50,000 or more).

### 6.2 Market Conditions and Timing of Initiative

The City has achieved tremendous economic success as a community and tourist destination over the past 50 years. Notwithstanding, the economy is shifting. With minimal development in the past 20 years, Laguna Beach (along with other Southern California communities) should consider the pressures on land use and occupancy that is imposed on commercial properties, as the digital economy converts the lifestyles and social patterns of every generation. With today's consumers using online websites for purchasing commodities, clothing, and a broad array of soft goods (e.g., Amazon and other expanding online platforms), communities are exposed to the reduction in traditional retail store format sizes. These trends are reinforced by downsizing, resizing, changes in market approach, and even bankruptcies and store closures that are impacting numerous major retail store chains. E-commerce sales in the U.S. have increased steadily over the past 10 years, capturing over 20% of all sales in 2020 due to the Covid-19 pandemic. This is putting additional pressure on traditional brick-and-mortar retailers that were already struggling prior to the pandemic. Pandemic conditions and related operating constraints serve to exacerbate pressures to adjust and reset.

As a result, today's economic forces demand flexible approaches to land use that can rapidly deploy diversification in uses and densities including significant changes in the use indoor and

outdoor space that blend public amenities with private attractions that give cities the opportunity to offer more compelling and competitive destinations and gathering places with restaurants, entertainment venues, and experiential retail, that in the aggregate can generate more consumer visits than simply a collection of traditional store fronts.

### 6.3 Case Study Research - Similar City Initiatives

The review of several similar city voter initiatives passed since 2000, found that those initiatives required General Plan or zoning changes, while Laguna Beach has more onerous triggers (square feet, traffic, parking, height limits) that apply to small projects. Even with that distinction, Kosmont did not find any projects that went through the required election process that were approved.

Kosmont's research found that voter approval requirements add a significant element of risk and uncertainty that can discourage investment in new projects, as well as rehabilitation of underutilized or blighted properties. The coastal development process contains many levels of risk without imposing an expensive and time-consuming voter approval process.

### 6.4 Cumulative Effect Provision

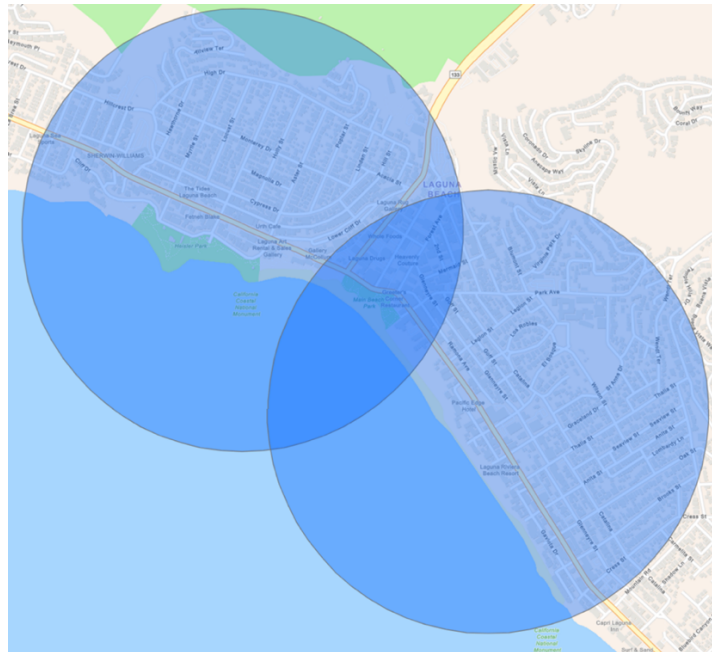
One of the critical standards used to define a Major Development Project is whether the Project will cause a "Cumulative Effect" – that when considered with other defined cumulative projects that have received prior approval, or are pending approval in the entitlement process, will cause more than a cumulative 800 Average Daily Trips or more than 88,000 SF of gross floor area. The cumulative projects include any project greater than 3,000 SF within one-half mile of the newly considered project that fall within the geographic area.

Consider the two projects that are currently Applications In Process: The Museum Hotel project, located at 305-397 N. Coast Highway, and The Cleo Hotel Project, located at 680-690 and 696 S. Coast Highway. Each of these projects on their own exceeds 88,000 SF, and each may create 200 or more additional average daily trips.

To the extent that any new project is proposed within one-half mile (an area which includes the vast majority of downtown Laguna Beach) while these projects are still under review, **any new** square footage would lead to a "cumulative effect" and would thus trigger the need for voter approval (unless the project is exempted under 25.60.03(c)).

See Figure 6.1 on the following page with a ½ mile radius drawn around the two proposed projects highlighted. Looking at the map, it appears that virtually any additional square footage planned in downtown area, or any increase to Average Daily Trips in a new project would trigger the "Cumulative Effect" requirement for voter approval.

**Figure 6.1**  
**Cumulative Effect Boundary from New Hotel Proposals**



## 6.5 Commercial Tax Revenue Impact

Kosmont has prepared an analysis of potential fiscal impact if the provisions of the Initiative become law. Recognizing that most development proposals that have required voter approval have failed, Kosmont estimated a 10% to 30% range of projects approved by voters based on those submitted in the past four years, as a proxy for future development. Kosmont also assumes a reduction in the General Fund impact of 25% from competition to other businesses / existing commercial activity, also known as “cannibalization”. As illustrated below, the potential loss to General Fund revenues within a 4-5year period ranges from \$1.5 to \$2 million per year.

### General Fund Revenue Impact – Recent Projects

		10% Voter Approval	30% Voter Approval
Loss of Gross Tax Revenues		(\$2,700,000)	(\$2,100,000)
25% Cannibalization		<u>675,000</u>	<u>525,000</u>
<b>Annual GF Impact (Loss)</b>		<b>(\$2,025,000)</b>	<b>(\$1,575,000)</b>

Source; Kosmont Companies

These impacts are cumulative, meaning that the longer the voter requirement remains in effect, the greater the annual loss. For example, after 10 years, the loss of similar development projects in the following five years, could mean a cumulative loss of \$3 million to \$4 million per year.



## 7.0 Appendix

### 7.1 Illustration of Municipal Services Costs

While the majority of General Fund costs are for the benefit of Laguna Beach residents, there are significant public safety costs associated with 6 million annual tourist visits to the City according to Visit Laguna statistics.

A review of the City budget specifically found that police service costs of \$22.3 million per year represent 30% of the budget allocated to all 22,000 residents x 365 days and 6 million annual visitors (a total of 14.03 million person-days) – amount to average allocated police costs of \$1.59 per person-day.

POLICE COSTS		
Annual Police Budget		\$22,300,000
Residents	22,000	
Annual Resident Days		8,030,000
Annual Visitors		6,000,000
Total Days		14,030,000
Police Cost per person day		\$1.59

*Source: City Budget, Kosmont Companies*

An increase in tourist visits from two new 100-room hotels represents a 15% increase in the overall supply. After factoring potential 25% cannibalization from existing hotel room supply, there would be an increase of approximately 80,000 person days, resulting in increased police costs of \$130,000 per year.

Other departments – such as paramedics, public works, etc. – will realize an increase in service costs if tourism increases, however the impact would likely be relatively small.

## 7.2 Hotel Inventory

Property Name	Property Address	Rooms	Class	Scale	Year Built / Renovated	Mtg Space
Montage Laguna Beach	30801 Coast Hwy	258	A	Luxury	2019	11,940
Casa Laguna Hotel & Spa	2510 S Coast Hwy	23	C	Independent	2016	150
Inn at Laguna Beach Ocean View	211 N Coast Hwy	39	B	Independent	2012	
Inn at Laguna Beach	211 N Coast Hwy	31	B	Independent	2012	1,100
Coast Inn	1401 S Coast Hwy	24	C	Independent	(under renovation)	
Surf & Sand Resort	1555 S Coast Hwy	167	C	Independent	2010	9,287
The Retreat in Laguna	729 Ocean Front	8	B	Independent	2010	
Seaside Laguna Inn & Suites	1661 S Coast Hwy	25	B	Independent	2008	
Seven4one	741 S Coast Hwy	12	B	Independent	2008	
Hotel La Casa Del Camino	1289 S Coast Hwy	37	A	Independent	1996	3,000
Art Hotel	1404 N Coast Hwy	28	C	Independent	1992	
Laguna Brisas Hotel	1600 S Coast Hwy	66	C	Independent	1986	600
Laguna Beach House	475 N Coast Hwy	36	C	Independent	1984	150
14 WEST Laguna Beach	688-690 S Coast Hwy	14	B	Independent	1973	
Hotel Joaquin	985 N Coast Hwy	22	A	Independent	1970	
Holiday Inn Laguna Beach	696 S Coast Hwy	54	B	Upper-Mid	1964	285
Pacific Edge Hotel	627-668 Sleepy Hollow Ln	125	C	Independent	1963	7,000
The Ranch at Laguna Beach	31106 Coast Hwy	97	C	Independent	1963	6,278
Sunset Cove Villas	683 Sleepy Hollow Ln	8	A	Independent	1963	
Laguna Beach Lodge	30806 Coast Hwy	40	C	Independent	1960	216
Capri Laguna Inn	1441 S Coast Hwy	45	C	Independent	1955	400
The Tides Laguna Beach	460 N Coast Hwy	21	C	Independent	1951	
Laguna Riviera Hotel	825 S Coast Hwy	53	C	Independent	1947	
Crescent Bay Inn	1435 N Coast Hwy	30	C	Independent	1947	
Hotel Laguna Resort	425 S Coast Hwy	65	C	Independent	1930	3,500
Carriage House Bed & Breakfast	1322 Catalina St	8	C	Independent	1930	
Laguna Beach Inn	2020 S Coast Hwy	23	C	Independent	1929	

Source: CoStar, Smith Travel Research