



CITY OF MORGAN HILL

Morgan Hill 2035
Existing Conditions White Papers

ECONOMICS 1

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Public Review Draft

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ECONOMICS 1

This white paper is a background document intended to serve as a resource in the development of the Morgan Hill 2035 project. The white paper contains information about demographic and housing conditions in Morgan Hill, including unemployment and commute flow trends, retail trends, real estate market conditions, and Citywide fiscal trends. This white paper focuses on evaluating Morgan Hill's competitive position within the broader Santa Clara County market area and in defining the City's long-term prospects for capturing retail, office, and industrial growth within the broader market area.

The objective of this white paper is to provide Morgan Hill 2035 participants, including the public, the consultant team, City staff, and City policymakers with a common understanding of economic trends and characteristics in Morgan Hill over the course of the General Plan horizon.

Economic Profile

The following economic profile provides an analysis of economic characteristics and trends in Morgan Hill, using Santa Clara County and the State of California as benchmarks for comparison where appropriate. The analysis draws on data from the 2000 and 2010 US Census, American Community Survey (ACS), current estimates obtained from private data vendors, data from the California Economic Development Department (EDD), market reports from commercial property brokers, interviews with brokers and leasing agents familiar with Morgan Hill, and recent studies conducted by consultants for the City.¹ Projected future household and employment growth is based on targets presented in the One Bay Area Jobs-Housing Connection Strategy released by the Association of Bay Area Governments (ABAG) and Metropolitan Transportation Commission (MTC) in May 2012.

Recent Growth Trends

Population and Households

Between 2000 and 2013, Morgan Hill experienced modest population growth. As shown in Table 1-1, the City's population and number of households grew by approximately 17 percent, or 1.2 percent per year; this rate of growth was faster than either Santa Clara County overall or the State of California. During the same period, the population increased by only 10 percent for Santa Clara County and 13 percent for California, while the number of households increased by only 11 percent for the County and 12 percent for the state.

Employment

Table 1-2 provides data on jobs located in Morgan Hill based on data from the US Census and ACS. The data capture all jobs for which the workplace is located in Morgan Hill, rather than jobs held by Morgan Hill residents. The industries located in Morgan Hill are largely similar to those in Santa Clara County overall, indicating that the economic activity in Morgan Hill is closely tied to the Silicon Valley economy. According to ACS data collected between 2007 and 2011, manufacturing accounted for the largest share of employment both in the City and the county, comprising 21 percent of all employment in Morgan Hill and 20 percent in Santa Clara County. In Morgan Hill, significant

¹ The U.S. Census American Community Survey (ACS) publishes estimates of demographic conditions based on continuous statistical sampling. While these data cannot represent conditions at a specific point in time, as in decennial censuses, they are updated on an annual basis and offer a valuable means to compare characteristics across geographies.

TABLE 1-1 **POPULATION AND HOUSEHOLD TRENDS, 2000-2013**

	2000	2013	Annual % Change 2000-2013	Total % Change 2000-2013
Morgan Hill				
Population	34,104	39,876	1.2%	16.9%
Households	10,945	12,838	1.2%	17.3%
Santa Clara County				
Population	1,682,579	1,843,474	0.7%	10%
Households	565,871	626,424	0.8%	11%
California				
Population	33,876,636	38,199,831	0.9%	13%
Households	11,502,899	12,883,977	0.9%	12%

Source: Nielsen Marketplace, 2013. Based on U.S. Census 2000 and 2010 and other sources; BAE, 2013.

manufacturers include Anritsu, Specialized Bicycles, and TenCate Advanced Composites. Educational and health services, which includes the school district and medical offices, was the second largest employment sector (17 percent of employment in the City and 19 percent of employment in the county) followed by professional and business services (13 percent of employment in the City and 18 percent of employment in the county). Compared to Santa Clara County overall, Morgan Hill had a relatively large share of jobs in the financial activities and leisure/hospitality sectors, which accounted for 8 percent and 9 percent of all employment in the City, respectively.

ACS data collected between 2007 and 2011 indicate that Morgan Hill has experienced a net increase in employment since the 2000 US Census, while employment decreased slightly on a countywide basis, as shown in Table 1-2. With respect to total net new jobs, the most significant growth industries in Morgan Hill were educational and health services, professional and business services, financial activities, and leisure and hospitality. Educational and health services was the fastest growing industry sector in Santa Clara County overall.

TABLE 1-2 **EMPLOYMENT BY INDUSTRY BY WORKPLACE LOCATION**

Industry	2000		2007-2011 ^b	
	Number	% Total	Number	% Total
Workers Employed in Morgan Hill^a				
Agriculture, Forestry, Fishing/Hunting, & Mining	225	1.7%	65	0.4%
Construction	1,025	7.9%	878	5.6%
Manufacturing	3,190	24.7%	3,296	20.9%
Wholesale Trade	810	6.3%	682	4.3%
Retail Trade	1,905	14.7%	1,430	9.0%
Transportation, Warehousing & Utilities	80	0.6%	80	0.5%
Information	235	1.8%	704	4.5%
Financial Activities	605	4.7%	1,221	7.7%
Professional & Business Services	1,195	9.2%	2,047	13.0%
Educational & Health Services	1,780	13.8%	2,645	16.7%
Leisure & Hospitality	880	6.8%	1,479	9.4%
Other Services	745	5.8%	917	5.8%
Public Administration	250	1.9%	360	2.3%
Armed Forces	0	0.0%	0	0.0%
Total^c	12,930	100.0%	15,804	100.0%
Workers Employed in Santa Clara County				
Agriculture, Forestry, Fishing/Hunting, & Mining	4,175	0.4%	5,043	0.5%
Construction	50,350	5.3%	52,694	5.7%
Manufacturing	259,060	27.4%	188,174	20.2%
Wholesale Trade	28,795	3.0%	21,401	2.3%
Retail Trade	91,170	9.6%	86,783	9.3%
Transportation, Warehousing & Utilities	26,270	2.8%	24,811	2.7%
Information	45,500	4.8%	39,201	4.2%
Financial Activities	41,000	4.3%	44,797	4.8%
Professional & Business Services	150,515	15.9%	166,734	17.9%

Industry	2000		2007-2011 ^b	
	Number	% Total	Number	% Total
Educational & Health Services	139,755	14.8%	175,875	18.9%
Leisure & Hospitality	52,580	5.6%	62,436	6.7%
Other Services	32,100	3.4%	36,184	3.9%
Public Administration	24,750	2.6%	25,064	2.7%
Armed Forces	725	0.1%	755	0.1%
Total^c	946,755	100.0%	929,952	100.0%

^a Data on workers employed in Morgan Hill refers to jobs located within Morgan Hill City limits, based on data from the US Census and American Community Survey (ACS).

^b The ACS data used in this table is based on statistical sampling conducted between 2007-2011.

^c Totals may not equal the sum of parts due to independent rounding. Data is reported for workers age 16 and over.

Source: 2000 Census Transportation Planning Package; ACS, 2007-2011; BAE, 2013.

Meanwhile, both Morgan Hill and Santa Clara County experienced a net decrease in employment within some sectors. In Morgan Hill, the sector with the largest decrease in total jobs was retail trade, which, as a result of the recession, likely reflects a combination of store closures along with reductions in payroll at the stores that remained. The sector with the largest decrease in Santa Clara County overall was manufacturing, however, the number of manufacturing jobs in Morgan Hill remained relatively consistent between these two time periods. Morgan Hill experienced a decline in employment in the agriculture, forestry, fishing, hunting, and mining industry, while the number of jobs in this industry increased in Santa Clara County overall. However, since the figures for Morgan Hill do not capture jobs outside of the City, it is not clear from the data whether there has been any change in the number of agriculture, forestry, fishing, hunting, and mining industry jobs in areas near the City and outside of City limits, which may represent the majority of the agricultural activity in the Morgan Hill area.

These trends demonstrate the importance of manufacturing, educational and health services, and leisure and hospitality to the Morgan Hill employment base. Although the manufacturing sector has not shown much growth in recent years, it has remained steady in Morgan Hill despite declines elsewhere. Consistent with trends throughout the county and state, educational and health services has become an increasingly significant employment industry in Morgan Hill over time, a trend that is likely to continue. The leisure and hospitality industry has represented a growing share of employment in Morgan

Hill in recent years, suggesting that the City's recreational and visitor amenities are becoming increasingly significant local economic assets.

Growth Projections

As mentioned above, growth projections provided in this report are based on targets presented in the One Bay Area Jobs-Housing Connection Strategy released by ABAG and MTC in May 2012. The Jobs-Housing Connection Strategy projects future growth throughout the Bay Area through 2040 based on a regional model that estimates overall population and employment growth. That growth is then allocated to various jurisdictions and subareas based on an inventory of available land for development as well as policy objectives.

Households

The growth targets shown in the Jobs-Housing Connection Strategy indicate that household growth will occur at a slightly slower rate in Morgan Hill than in Santa Clara County overall between 2010 and 2040, counter to recent trends. As shown in Table 1-3, the Strategy estimates that the number of households in Morgan Hill will increase by 31 percent (+3,800 households) during this time period, at an average rate of 0.9 percent per year, slower than the average annual growth rate in the City between 2000 and 2013 (shown in Table 1-1). Meanwhile, the number of households throughout Santa Clara County will increase by 36 percent (+215,000 households), at an average rate of 1 percent per year, faster than the average annual rate of growth in the county between 2000 and 2013 (shown in Table 1-1). The difference in these growth rates will have a minimal impact on Morgan Hill's share of county households. According to ABAG figures, Morgan Hill is estimated to account for approximately 2 percent of all households in Santa Clara County in both 2010 and 2040.

Employment

The Jobs-Housing Connection Strategy projects that, unlike the period from 2000 to 2011, Morgan Hill will experience slower employment growth than the County; however, it should be noted that these projections reflect regional policy objectives and are not necessarily deterministic of future trends. As shown in Table 1-3, ABAG projects that there will be 22,080 jobs located in Morgan Hill in 2040, a 26-percent increase over 2010. Meanwhile, employment throughout the county will increase by 33 percent, reaching 1,229,800 jobs by 2040.

ABAG's projected increase of about 4,600 new jobs in Morgan Hill between 2010 and 2040 includes employment that will be housed in a range of building types, including retail and services, offices, industrial, and research and development (R&D). Employment densities in these buildings could range

from under 200 square feet per employee to 750 square feet or more per employee. If the average employment density was assumed to be approximately 350 to 450 square feet per employment across all categories, this would translate to approximately 1.6 million to about two million square feet of building space.

TABLE 1-3 **PROJECTED HOUSEHOLD AND EMPLOYMENT GROWTH, 2010-2040**

	2010	2040 ^a	Change 2010-2040	Annual % Change 2010-2040	Total % Change 2010-2040
Households					
Morgan Hill	12,326	16,147	3,821	0.9%	31.0%
Santa Clara County	604,204	819,129	214,925	1.0%	35.6%
Employment					
Morgan Hill	17,523	22,080	4,556	0.8%	26.0%
Santa Clara County	926,260	1,229,800	303,540	0.9%	32.8%

Note: Projections from ABAG Jobs-Housing Connection Strategy, May 16, 2012.
Source: ABAG, 2012; BAE, 2013.

Jobs/Housing Ratio

A jobs-to-housing ratio demonstrates the balance between jobs and housing units within a community. It is found by dividing the number of jobs in the community by the number of households in the same area. A high number of jobs relative to a low number of housing units indicates that workers must commute into the community. A low number of jobs and high number of housing units means workers must commute out to jobs. In contrast, a healthy jobs/housing ratio, which is region-specific, as described further below, increases opportunities for residents to work locally, decreasing congestion and commute time, and improving workers’ productivity and quality of life. Moreover, a strong and diversified local job base supports fiscal health, helping local governments endure fluctuations in different segments of the regional and national economies.

Economists and land use planners often use the region as a benchmark for a healthy jobs/housing ratio, based on the notion that Bay Area employers generally draw their workforce from within the region. The Jobs-Housing Connection Strategy estimates that the region had approximately 1.3 jobs per

household in 2010, and projects this ratio to grow somewhat to 1.36 jobs per household by 2040.² In contrast, Morgan Hill's 2010 jobs/housing ratio is 1.42 jobs per household, which is a healthy ratio, and higher than the regional ratio. Santa Clara County's ratio is currently even higher, at 1.53 jobs per household.

In both Morgan Hill and Santa Clara County, the targets presented in the Jobs-Housing Connection Strategy indicate that household growth is projected to outpace employment growth, resulting in a slightly lower ratio of jobs per household in 2040 than in 2010, though the difference over time is not substantial in either jurisdiction. In Morgan Hill, the ratio is projected to decrease from 1.42 jobs per household in 2010 to 1.37 in 2040;³ throughout Santa Clara County, the ratio is projected to decrease from 1.53 to 1.50 jobs per household during this time.

Since Morgan Hill currently has an average of approximately 1.3 employed residents per household, the current and projected ratio of jobs to households in Morgan Hill indicate a relatively healthy balance of land uses in the City, providing opportunities for employed residents to work locally. However, the extent to which residents will work locally depends in part on complex relationships between the housing types available in the City, the skills and education levels among the City's labor force, and the jobs that are located in the City. In no Bay Area community do all employed residents work in the city where they live, nor do all people employed in any given city live in that city. Nor does a jobs/housing balance ratio represent the type, pay, or quality of local jobs related to the education and skill set of the Morgan Hill residents who also work here.

In Morgan Hill, it may be possible to increase the number of local workers who also live in Morgan Hill, by improving the match between the type and affordability level of local housing options, the quality of jobs, and the incomes and preferences of local workers. Given that some degree of cross-commuting is expected to continue, consideration should be given to improving the accessibility to and from Morgan Hill relative to other locations. Commute patterns are discussed in further detail in a subsequent section.

² ABAG and MTC, *Jobs-Housing Connection Strategy, Revised May 16, 2012*. See Table 2.2. Regional Totals, 2010 and 2040, page 14. Accessed online at http://scs.abag.ca.gov/pdf/JHCS/May_2012_Jobs_Housing_Connection_Strategy_Main_Report.pdf, on March 28, 2013.

³ This ratio is based on ABAG projections in the Jobs-Housing Connection Strategy, and, as noted above, these projections reflect regional policy objectives and are not necessarily deterministic of future trends. Historical job trends indicate that higher job growth may occur.

Employment Status

The employment rate is the percentage of the labor force (i.e. people who are either actively employed or actively seeking employment) that is employed, based on area of residence. For example, the employment rate for Morgan Hill represents the percentage of Morgan Hill residents in the labor force that are actively employed, regardless of where their jobs are located. Since the employment rate for Morgan Hill refers to the people that live in the City rather than people employed in the City, it does not have a direct relationship to the jobs that are located in Morgan Hill.

According to data from the California Employment Development Department (EDD), Morgan Hill had 18,400 residents in the labor force as of March 2013, 16,700 of whom were employed. At 9.2 percent, the unemployment rate in Morgan Hill was slightly lower than the statewide unemployment rate (9.4 percent). Throughout Santa Clara County, the unemployment rate was somewhat lower, at 7.1 percent (see Table 1-4).

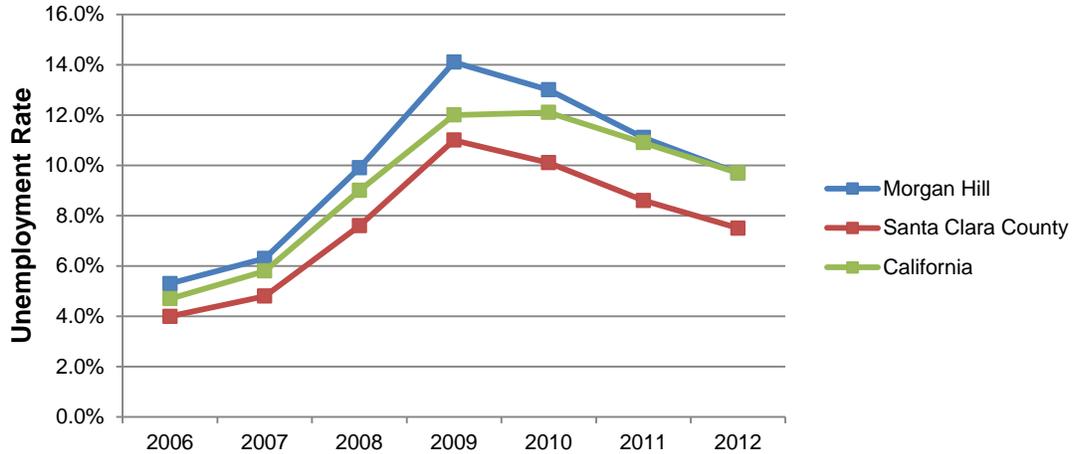
TABLE 1-4 **EMPLOYMENT STATUS, MARCH 2013**

Geography	Number of Workers		Unemployment Rate
	Employed	In Labor Force	
Morgan Hill	16,700	18,400	9.2%
Santa Clara County	858,500	924,300	7.1%
California	16,817,200	18,557,700	9.4%

Note: Data are not seasonally adjusted.
 Source: CA EDD, 2013; BAE, 2013.

Figure 1-1 shows the December unemployment rate for each year between 2006 and 2012 for Morgan Hill, Santa Clara County, and California. The December unemployment rate in all three geographies increased each year between 2006 and 2009, reflecting the nationwide recession. At the peak in 2009, the December unemployment rates in Morgan Hill, Santa Clara County, and California reached 14.1 percent, 11.0 percent, and 12.0 percent, respectively. In both Morgan Hill and Santa Clara County, the December unemployment rate began to decline in 2010 and has dropped further in 2011 and 2012. The unemployment rate in all three geographies remained 3.5 to 5.0 percentage points higher in December 2012 than in December 2006, meaning neither the State, the County, nor Morgan Hill has fully recovered from the recession, although they have continued to show improvement through March of this year.

Figure 1-1 December Unemployment Rate, 2006-2012



Sources: CA EDD, 2013; BAE, 2013.

Between 2006 and 2012, the December unemployment rate in Santa Clara County remained lower than the statewide rate by 0.7 to 2.3 percentage points. Meanwhile, the December unemployment rate in Morgan Hill was higher than the statewide rate by 0.2 to 2.1 percentage points between 2006 and 2011, then converged with the statewide rate in December 2012. The Morgan Hill rate also showed more total fluctuation than either the countywide or statewide rate. Together, these data suggest that while the economy is generally strong in Santa Clara County overall, the Morgan Hill economy is more sensitive to economic cycles. However, trends in Morgan Hill do mirror countywide trends, as evidenced by the Citywide decline in the unemployment rate in 2010, which occurred in conjunction with the countywide decline and in advance of the statewide decline.

Commuter Flows

Table 1-5 shows work locations for Morgan Hill residents, as well as where people employed in Morgan Hill live, based on ACS data collected between 2006 and 2008 (the most recent time period for which this data is available).⁴

⁴ Note that the ACS data report a lower total number of persons employed in Morgan Hill than ABAG, which estimated closer to 17,500 jobs in Morgan Hill for 2010; however, the ACS data are shown here because this source provides detailed information on commute flows, which is not available from ABAG. Although the job totals may vary, the ACS data are useful to gain a general understanding of patterns of commuting into and out of Morgan Hill.

TABLE 1-5 **COMMUTE FLOWS, MORGAN HILL**

Morgan Hill Residents by Place of Work	Employed Persons	
	Number	Percentage
Santa Clara County	15,819	91.9%
San Jose	5,535	32.2%
Morgan Hill	4,780	27.8%
Gilroy	1,005	5.8%
Santa Clara	730	4.2%
Sunnyvale	650	3.8%
Mountain View	375	2.2%
Palo Alto	335	1.9%
Milpitas	310	1.8%
Cupertino	210	1.2%
Campbell	190	1.1%
Other Cities	170	1.0%
Unincorporated	1,529	8.9%
All Other Locations	1,391	8.1%
Total	17,210	191.9%
Morgan Hill Workers by Place of Residence	Number	Percentage
Santa Clara County	11,980	79.4%
Morgan Hill	4,780	31.7%
San Jose	3,520	23.3%
Gilroy	1,860	12.3%
Other Cities	6209	4.1%
Unincorporated	1,200	8.0%
San Benito County	680	4.5%
Merced County	505	3.3%
Alameda County	385	2.6%
Monterey County	345	2.3%
Santa Cruz County	285	1.9%
San Mateo County	215	1.4%
All Other Locations	690	4.6%
Total	15,085	100.0%

Note: The American Community Survey (ACS) data used for the most recent Census Transportation Planning Package (CTPP) uses demographic estimates based on statistical sampling conducted between 2006-2008. Data is reported for workers age 16 and over.

Source: 2006-2008 Census Transportation Planning Package; ACS, 2006-2008; BAE, 2013.

According to this data, an estimated 4,780 people both lived and worked in Morgan Hill, which amounts to 28 percent of employed Morgan Hill residents. Almost one third (32 percent) of Morgan Hill residents worked in San Jose, making San Jose the most common workplace for Morgan Hill residents.

In total, 92 percent of employed Morgan Hill residents worked within Santa Clara County, most of whom were employed in cities north of Morgan Hill. Residents that commuted to work locations south of Morgan Hill included a small portion of the City's employed population (6 percent) that commuted to Gilroy. It is possible that some of the 9 percent of employed residents that worked in unincorporated Santa Clara County and the 8 percent of employed residents that commuted to locations outside of Santa Clara County may also commute to locations to the south. However, the commute data indicate that the vast majority of employed Morgan Hill residents have a northbound work commute.

With respect to people employed in Morgan Hill, the data indicate that one third of people working in Morgan Hill were also Morgan Hill residents. San Jose residents made up approximately one-quarter of people employed in Morgan Hill. Overall, 79 percent of people employed in Morgan Hill lived in Santa Clara County. While these data show some commute flow south into Morgan Hill from locations to the north, employees from Gilroy, San Benito County, Merced County, Monterey County, and Santa Cruz County account for approximately one-quarter of the people employed in Morgan Hill, demonstrating that Morgan Hill workers commute from a number of directions.

Caltrain provides limited one-way morning and evening weekday service for Morgan Hill commuters. The train makes a total of six stops at the Morgan Hill station each weekday, which consist of three northbound trains in the mornings and three southbound trains in the evenings. This schedule allows Morgan Hill residents to commute to employment locations to the north, including San Jose, but does not provide service for people that live further north to commute to Morgan Hill for jobs. Some local business owners have indicated that enhanced Caltrain service to Morgan Hill would make the City a more desirable employment location.

Retail Trends

Data on taxable sales in Morgan Hill were provided by City staff, which receives quarterly reports on the City's sales tax revenue from MuniServices.⁵ The most recent quarter for which data are available is the third quarter of 2012 (Q3 2012). The data are provided on a rolling average annual basis each quarter, which means that the totals shown for Q3 2012 encompass data for an entire year, starting in the fourth quarter of 2011 (Q4 2011) and ending in Q3 2012. Overall, taxable sales in Morgan Hill have increased steadily in recent years. During the year spanning from Q4 2009 through the Q3 2010, taxable sales in Morgan Hill totaled \$463 million. The data for Q4 2011 through Q3 2012 show that taxable retail sales during this later period totaled \$626 million, a 35 percent increase in two years.⁶

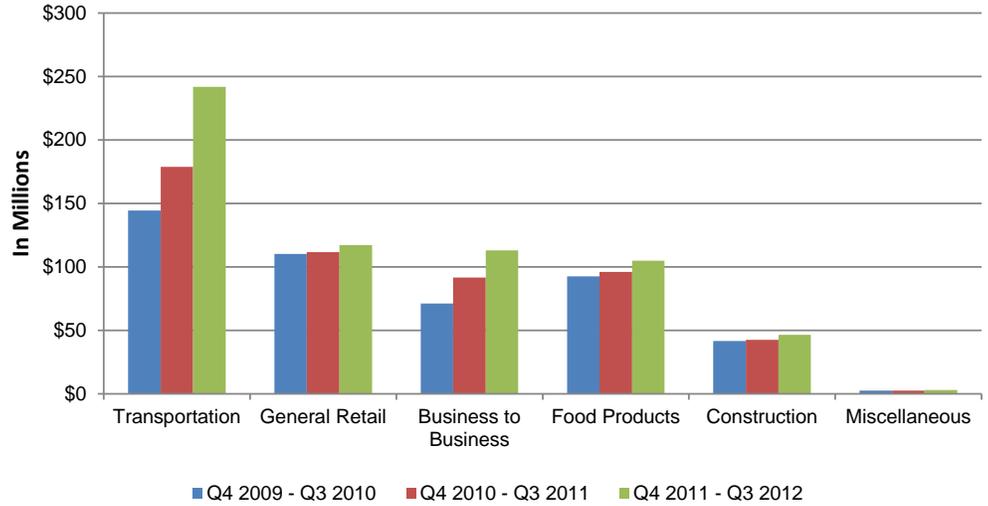
Figure 1-2 shows the breakdown of these totals by major category. As shown, sales in the transportation sector, which includes auto sales, service station sales, and auto parts and repair, account for a significant and growing share of total taxable sales in Morgan Hill. Business to business taxable sales, though a smaller portion of total taxable sales, have been increasing in Morgan Hill during recent years, accounting for a growing share of all taxable sales.

Figure 1-3 shows the six largest subcategories for taxable sales in Morgan Hill. As shown, service stations and sales by new automobile dealers were the largest generators of taxable sales in the most recent year for which data are available. Sales by electronic equipment outlets, which are classified as business-to-business taxable expenditures rather than retail sales, have also increased steadily in recent years. Restaurants have accounted for a significant and growing source of taxable sales in Morgan Hill during recent years; however, growth in restaurant taxable sales has not been as substantial as growth in service station, new automobile, or electronic equipment taxable sales.

⁵ Because of the way the taxable sales data was packaged, business to business sales were included in much of this analysis as it was not possible to separate it out. For example Transportation includes auto dealers and vehicle repair. Construction includes both retail and wholesale outlets. Therefore, although Figure 1-2 shows a separate business-to-business sales category, business-to-business sales are also captured in the other categories.

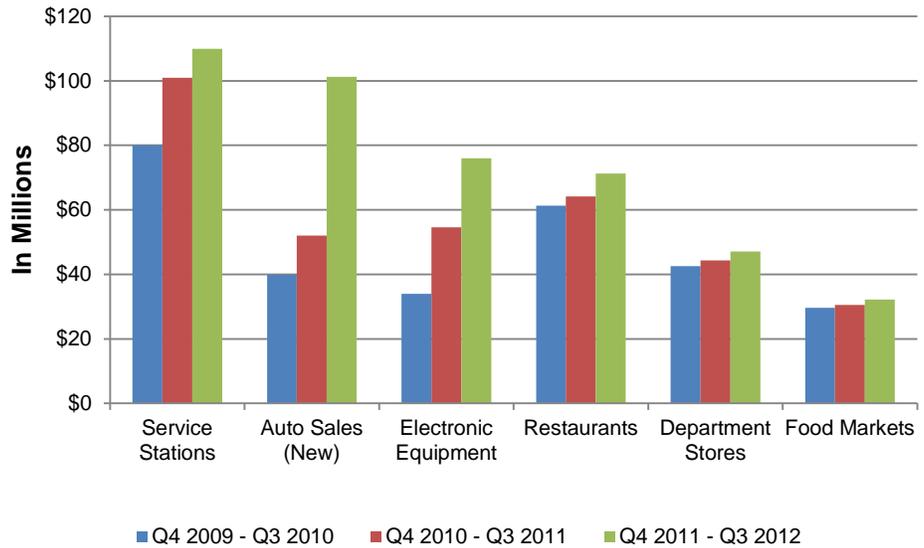
⁶ It should be noted that taxable sales does not encompass all retail sales; for instance, grocery and prescription items are not taxable; as a "rule of thumb" typically approximately one-third of food store or drug store sales are taxable, so these store types, or other stores selling a substantial amount of these items (e.g. Walmart food sales), have total sales higher than indicated here.

Figure 1-2 Taxable Retail Sales by Major Category, Morgan Hill, Q4 2009 to Q3 2012



Sources: MuniServices, 2012; BAE, 2013.

Figure 1-3 Taxable Retail Sales in the Six Largest Subcategories, Morgan Hill, Q4 2009 to Q3 2012



Sources: MuniServices, 2012; BAE, 2013.

Real Estate Market Conditions

This section provides an overview and analysis of current real estate market conditions in Morgan Hill and Santa Clara County. The overview presents data on the existing inventory, lease rates, and occupancy levels among office, R&D, industrial, and retail properties, based on brokerage firm reports and online property listings. These data sources are supplemented by quantitative and qualitative information on local real estate conditions obtained through interviews with local property managers and brokers.

Office

According to the commercial brokerage firm Colliers International, the office real estate inventory in Morgan Hill is relatively limited. Colliers reports that the office inventory for the Morgan Hill submarket was about 686,000 square feet as of the first quarter of 2013.

However, data from Colliers also indicate that the Morgan Hill office real estate submarket is weaker than other locations in Silicon Valley, as indicated by vacancy rates, asking lease rates, and absorption. Since third quarter 2012, Morgan Hill's vacancy rate has hovered around 28 percent. This is considerably higher than the 16.7 percent Silicon Valley vacancy rate reported by Colliers for third quarter 2012 (see Table 1-6), and higher than all other submarkets. Since third quarter 2012, Morgan Hill's weighted average asking office rent has been steady at about \$1.65 per square foot; meanwhile, the Silicon Valley average rent was \$2.79 per square foot (see Table 1-6). Morgan Hill's average rent was also considerably below the rents in all other Silicon Valley submarkets. In addition, Morgan Hill had negative office absorption in the first quarter 2012 to third quarter 2013 period in comparison to positive absorption of almost 900,000 square feet throughout Silicon Valley as a whole for the same period.

As shown in Table A-1 in Appendix A, office space that is currently available for lease in Morgan Hill is somewhat scattered within the area defined by Highway 101 to the east, Tennant Avenue to the south, Monterey Street to the west, and extending slightly north of Cochrane Road, mainly within the City's industrial and R&D areas, which will be discussed in further detail in the following section. In addition to office development within industrial and R&D areas, a portion of the City's available office space is located on the second floor above retail in mixed-use shopping centers, including in Harvest Plaza at the East Dunne Avenue exit of Highway 101. Asking rents for the office properties shown in Table A-1 of Appendix A range from \$1.25 to \$1.75 per

square foot per month, though most fall below the Morgan Hill/Gilroy averages cited in Table 1-6.⁷

Industrial

Morgan Hill has a large and diverse industrial sector, which includes both traditional industrial/manufacturing facilities as well as flex/R&D type facilities associated with the high tech sector. Some prominent industrial tenants include companies such as Anritsu and Infineon Technologies in the tech sector, Lusamerica and Del Monaco Foods in the food sector, and Specialized Bicycles and Fox Racing in the recreation sector.

The City of Morgan Hill previously commissioned an Economic and Fiscal Analysis of Proposed Industrial Land Conversion in Morgan Hill (Industrial Land Study) from Strategic Economics, which was completed in 2012. Included in the Industrial Land Study is background information on Morgan Hill's industrial economy, which highlights the importance of industrial real estate in Morgan Hill. According to data provided in the Industrial Land Study, manufacturing is the largest sector in Morgan Hill with respect to total employment, accounting for approximately 22 percent of all jobs located within Morgan Hill as of 2009, higher than the sector's share of employment throughout Santa Clara County, where manufacturing accounted for 19 percent of all jobs. These figures are in line with the industry data from the US Census and ACS presented in the preceding section on employment trends in Morgan Hill.

⁷ Asking rents for office properties in Morgan Hill represent triple net (NNN), modified gross, and full service lease rates. A full service lease is a lease under which maintenance, utilities, insurance, taxes, and other operating expenses are included in the rent. A triple net lease is a lease that requires the lessee to pay for maintenance, taxes, insurance, and utilities associated with the leased property, in addition to the monthly rental rate. A modified gross lease typically requires the lessee to pay some of these additional costs in addition to the monthly rental rate, and the remaining costs are covered by the property owner. The specific details of a modified gross lease can vary between properties. Since the asking rents for office properties in Morgan Hill represent all three lease types, effective rents (i.e. the total amount that an office tenant would pay per month on a square footage basis) may vary slightly from the range cited in the text, after controlling for lease type.

TABLE 1-6 **OFFICE REAL ESTATE MARKET AS OF THIRD QUARTER 2012**

Submarket	Inventory (SF)	Vacancy Rate	Net Absorption Q1-Q3 2012 (SF)	Avg. Full Service Asking Rent (per SF Monthly)	
				Class A	All Classes
Campbell/Los Gatos	3,000,994	16.0%	116,442	\$2.88	\$2.61
Cupertino/Saratoga	3,555,213	4.1%	64,744	\$4.12	\$3.67
Fremont/Milpitas	2,689,335	23.7%	21,912	\$1.90	^a
Morgan Hill/Gilroy	876,854	27.2%	(29,131)	\$1.65	\$1.63
Los Altos	1,049,944	14.5%	25,911	\$4.76	\$4.14
Mountain View	3,758,649	8.5%	4,485	\$5.14	\$3.97
Palo Alto	6,181,253	13.4%	43,045	\$5.17	\$4.99
San Jose	24,111,479	20.3%	(40,274)	\$2.68	\$2.32
Santa Clara	9,368,300	20.4%	284,050	\$3.30	\$2.75
Sunnyvale	7,437,477	10.6%	380,637	\$3.90	\$3.27
Silicon Valley Total	62,029,478	16.7%	871,801	\$3.22	\$2.79

Note: This table is based on a report that combined the Morgan Hill and Gilroy area. For data specific to Morgan Hill, see the text above.

^a The average asking rent for all classes in Fremont/Milpitas is reported to be \$41.81 per square foot (SF), full service. This is assumed to be an error and is excluded from this table.

Sources: Colliers International, 2012; BAE, 2013.

The key role of manufacturing to the Morgan Hill economic base is further highlighted by data provided by Colliers International, which indicate that the inventory of industrial, R&D, and warehouse space in Morgan Hill totaled around 5 million square feet as of the third quarter of 2012, more than five times the inventory of office space in Morgan Hill and Gilroy combined. As shown in Table 1-7, data from Colliers also demonstrate that vacancy rates and asking lease rates vary widely across cities throughout Silicon Valley. Cupertino had the lowest reported vacancy rate throughout Silicon Valley, with no vacant industrial, R&D, or warehouse space, while the vacancy rate in Fremont was estimated to be the highest, at 20 percent. At 13 percent, the

vacancy rate in Morgan Hill was slightly higher than the 12 percent vacancy rate in Silicon Valley overall.

TABLE 1-7 **INDUSTRIAL, R&D, AND WAREHOUSE REAL ESTATE MARKET AS OF THIRD QUARTER 2012**

Submarket	Inventory (SF)	Vacancy Rate	Net Absorption Q1-Q3 2012 (SF)	Average NNN Asking Rent (per SF Monthly)		
				R&D	Industrial	Warehouse
Campbell	1,949,214	13.0%	45,344	\$1.57	\$1.27	-
Cupertino	3,439,813	0.0%	-	-	-	-
Fremont	35,519,246	20.1%	(702,405)	\$0.81	\$0.73	\$0.48
Gilroy	4,955,732	14.6%	(53,607)	\$0.72	\$0.57	\$0.41
Los Gatos	448,159	9.3%	13,033	\$1.78	-	-
Milpitas	21,489,813	14.7%	488,278	\$0.95	\$0.80	\$0.48
Morgan Hill	4,956,381	13.3%	28,182	\$0.71	\$0.79	-
Mountain View	16,675,874	4.7%	93,916	\$2.03	\$1.12	-
Palo Alto	10,292,315	2.5%	7,7907	\$2.30	-	-
San Jose	85,666,895	12.6%	657,996	\$1.15	\$0.70	\$0.52
Santa Clara	36,029,454	11.2%	183,270	\$1.52	\$0.90	\$0.41
Sunnyvale	29,542,651	9.0%	500,594	\$1.72	\$0.99	\$0.73
Silicon Valley Total	252,752,739	12.2%	1,295,429	\$1.22	\$0.78	\$0.52

Sources: Colliers International, 2012; BAE, 2013.

Data provided by Colliers for Morgan Hill’s industrial and R&D properties indicate that there is variation in vacancy rate across these two product types, with the industrial vacancy rate in Morgan Hill at a low 7.38 percent as of first quarter 2013, while the local R&D vacancy rate was just under 18 percent in first quarter 2013. The R&D sector is the larger of the two in Morgan Hill, with approximately 2.7 million square feet, versus about 1.9 million square feet of industrial space.

As of the third quarter of 2012, the average asking rent for industrial space in Morgan Hill (\$0.79 per square foot per month triple net) was comparable to the average for Silicon Valley. However, Morgan Hill was considerably less competitive than other Silicon Valley locations within the R&D real estate market. While the average triple net asking rent for R&D space in Morgan Hill was \$0.71 per square foot per month, the average rate in Silicon Valley was \$1.22 per square foot per month.⁸ The high Silicon Valley average for R&D space was driven by particularly high average R&D rents in Palo Alto, Mountain View, Los Gatos, and Sunnyvale.

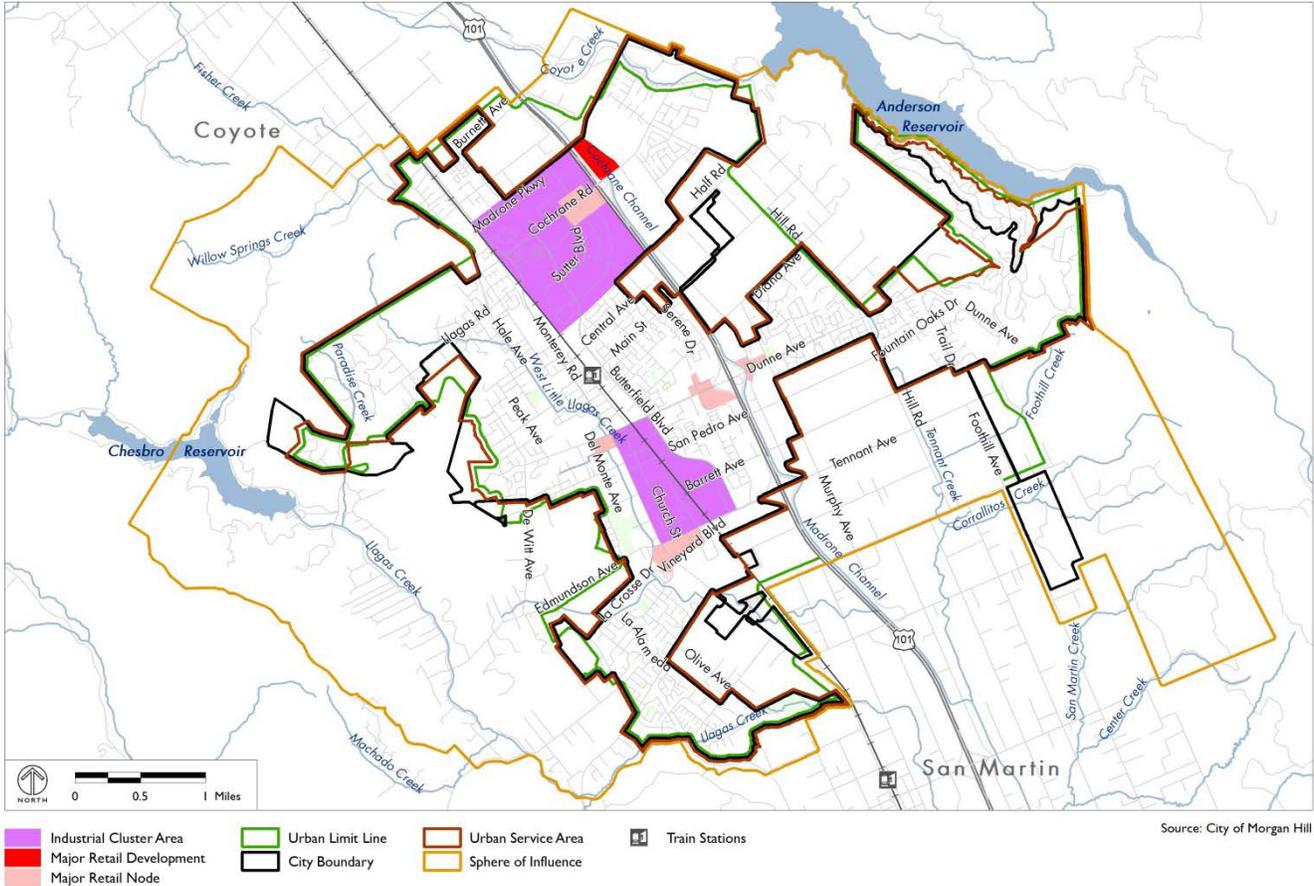
Within Morgan Hill, the industrial real estate market is somewhat bifurcated, with two distinct concentrations of industrial development, as noted in the Industrial Land Study. As shown in Figure 1-4, one concentration is in the northern portion of the City directly west of Highway 101, clustered around the Cochrane Road exit. The other concentration is located between Monterey Street and Butterfield Road, south of East Dunne Avenue and extending slightly south of Tennant Avenue. In comparison to properties in the Cochrane Road area, buildings in the East Dunne/Tennant Avenue area tend to be older and have a smaller footprint. According to the Industrial Land Study, the Cochrane Road area is the more desirable of the two industrial concentrations, because newer buildings and larger properties are available, and because the Cochrane Road exit on Highway 101 is the northernmost exit in Morgan Hill, enhancing the location's accessibility from San Jose and other locations to the north.

This bifurcation is not reflected in the asking lease rates shown in Table A-2 of Appendix A, which shows currently leasing industrial, R&D, and warehouse properties in Morgan Hill; however, the sample shown in the table is not sufficiently large to estimate an average lease rate for either area. Asking lease rates shown in Table A-2 of Appendix A range from \$0.55 to \$1.05 per square foot per month, with properties in both industrial areas at each end of this range.⁹

⁸ A triple net lease is a lease under which the lessee is responsible for maintenance, taxes, insurance, and utilities associated with the leased property, in addition to the monthly rental rate.

⁹ As with office properties, asking rents for industrial properties in Morgan Hill represent triple net, modified gross, and full service lease rates, so effective rents may vary slightly from the range cited after controlling for lease type.

Figure 1-4 Major Retail and Industrial Clusters, Nodes, and Developments



Retail

Morgan Hill has a number of retail nodes, most of which are located west of Highway 101. As shown in Figure 1-4, major retail nodes west of 101 include centers such as Cochrane Plaza, which is anchored by Walmart and Hobby Lobby; Lawrence Oaks Center, which is anchored by Safeway and Home Depot, and across the street from a small collection of standalone stores including Trader Joe’s and Walgreens; Vineyard Shopping Center, which is anchored by the Nob Hill grocery store and TJ Maxx; Morgan Hill Plaza, which includes Dollar Tree and Ross Dress for Less; and Tennant Station, which includes a Safeway and a movie theater complex. Madrone Village, a newer center located on the west side of Highway 101 at Cochrane Road and East Dunne Avenue, includes a number of restaurants, including Five Guys Burgers and Chipotle, as well as Anytime Fitness and Fedex Office. There are smaller

shopping centers adjacent to many of these centers, creating scattered retail destinations throughout the western portion of the City. In addition to these shopping centers, there is a cluster of retail offerings in the Downtown area along Monterey Road. Retail space Downtown is predominantly occupied by restaurants and independent boutique shops.

As shown in Figure 1-4, notable retail development east of Highway 101 includes a small retail cluster directly east of Highway 101 at the East Dunne Avenue exit, which consists primarily of fast food and other restaurants, and Cochrane Commons, a 250,000-square foot shopping center built in 2008, anchored by Target, Staples, Petco, and DSW Shoes. There is also a vacant former Circuit City space in the center, which is one of several similar-sized vacant spaces available within the City. Consolidation of the retail industry and a general trend towards use of smaller spaces for those chains that are remaining, including in the group of retailers who use 25,000 to 50,000 square foot spaces, means that it will likely be a challenge to find tenants for all of these spaces. The existing square footage at Cochrane Commons comprises Phase I of a planned 657,000-square-foot center. The remaining square footage has received planning entitlements, but construction is on hold due to the decline in the retail sector, and may not be fully realized due to market conditions.

As indicated in Table 1-8, Morgan Hill is grouped by most large retail real estate brokerages into a larger southern Santa Clara County submarket that includes Gilroy as well as Morgan Hill. Although this submarket is one of the larger ones in Santa Clara County, the City of Morgan Hill represents a relatively small portion of the submarket's inventory. The total square footage of twelve shopping centers identified in Morgan Hill, ranging in size from approximately 16,500 square feet to 266,600 square feet, is 1.3 million. Two centers, Cochrane Plaza and Madrone Village, have additional retail development capacity of 383,000 square feet and 42,000 square feet, respectively. As of February 2013, a windshield survey of Morgan Hill shopping centers indicated that there was approximately 129,000 square feet of vacant retail space, which indicates a vacancy rate of around 10 percent. In comparison, as shown in Table 1-8, the Santa Clara County retail market overall had a 6.4 percent vacancy rate, according to the fourth quarter 2012 retail market report by Terranomics, a commercial brokerage firm that tracks shopping centers throughout the Bay Area.

TABLE 1-8 **RETAIL REAL ESTATE MARKET AS OF FOURTH QUARTER 2012**

	Inventory (SF)	Vacancy Rate	Net Absorption 2012 (SF)	Avg. NNN Asking Rent (per SF/Monthly)
San Jose South & Downtown/Campbell/Los Gatos	17,893,612	5.5%	75,254	\$2.22
Sunnyvale/Cupertino	4,267,811	7.2%	(64,865)	\$2.87
anta Clara	2,453,405	7.3%	\$22,475)	\$2.37
Palo Alto/Mtn. View/Los Altos	2,389,907	3.0%	(12,820)	\$2.86
Milpitas/North San Jose	4,644,715	9.1%	154,539	\$2.23
Morgan Hill/Gilroy	4,595,869	8.4%	(36,678)	\$1.30
Santa Clara County Totals	37,738,910	6.4%	92,955	\$2.19

Source: Terranomics, 2012; BAE, 2013.

Separate from these shopping centers, Morgan Hill has both a Ford dealership and a Honda dealership, located on either side of Highway 101 at the East Dunne Avenue Exit. Tax revenue from these dealerships constitutes a significant portion of the City’s total sales tax base

As indicated by shopping center asking lease rates and data from Terranomics, the retail real estate market in Morgan Hill is less competitive in attracting tenants than in other cities in Santa Clara County. According to Terranomics, asking retail lease rates in the Morgan Hill/Gilroy submarket are the lowest out of all submarkets in the county, averaging \$1.30 per square foot per month during the fourth quarter of 2012 compared to \$2.19 on average countywide. The larger Morgan Hill/Gilroy submarket experienced increasing retail vacancies in 2012 and ended the year with a vacancy rate of 8.4 percent. This vacancy rate is higher than the countywide vacancy rate of 6.4 percent, indicating that other submarkets in Santa Clara County are comparatively more desirable retail locations. However, even Morgan Hill’s roughly 10 percent shopping center vacancy rate is not excessively high, indicating that as the market continues to recover and existing vacant retail space in the submarket is absorbed, the market may begin to support higher rents.

As shown in Table A-3 of Appendix A, asking rents for currently leasing retail properties in Morgan Hill range from \$1.00 to \$2.25 per square foot per month,

although the asking rate for most properties shown is below the average for the Morgan Hill/Gilroy submarket of \$1.30 per square foot (shown in Table 1-8).¹¹

Real estate brokers familiar with Morgan Hill report that the City faces competitive challenges in the retail sector, many of which were also outlined in a Draft Memorandum prepared by Hurst Harrigan Associates regarding “Morgan Hill Retail Strategy and Recruitment” in August 2011. Morgan Hill is positioned between San Jose, which provides a wealth of retail offerings, and Gilroy, which has attracted a number of large retail tenants, including a large outlet mall. Despite the relatively high income in Morgan Hill, the City’s population is perceived as being too small to support many retailers. Moreover, brokers report that regional and national retailers located in Morgan Hill indicate that the Morgan Hill stores tend to rank among the lowest of the stores in the chain in the region with respect to total sales.

The Morgan Hill retail trade area is constrained by factors including the City’s existing population, the RDCS and population cap and resulting pace of development, and a shared trade area with major shopping destinations in San Jose and Gilroy. In addition, in some retail categories, Morgan Hill appears to be over-retailed (i.e. retail supply exceeds local demand). For example, according to data compiled by the City’s sales tax consultant, MuniServices, Morgan Hill sales currently exceed expected local expenditures in the Food Markets category, and this calculation may not fully capture the food portion of total sales that occur in Target, Wal-Mart, and drugstores. This means that the Morgan Hill trade area currently experiences little to no leakage of expenditures for food purchases, and it would be difficult for another food store to enter the market and capture sufficient sales to be viable, without taking away market share from existing retailers.

Due to these current market conditions and competitive disadvantages, many retailers have chosen to locate either in San Jose or Gilroy rather than Morgan Hill, causing retail sales leakage as Morgan Hill residents leave the City to make many purchases. Brokers indicate that the City’s existing supply of retail space exceeds the projected demand in the City within the foreseeable future, even with the increase in population growth projected over the next 30 years, and that this oversupply has resulted in a large amount of vacant retail space and poses a threat to the future health and viability of the shopping centers. Nevertheless, there are also some retail categories in which local sales are

¹¹ As with office and industrial properties, rents for retail properties in Morgan Hill represent triple net, modified gross, and full service lease rates, so effective rents may vary slightly from the range cited after controlling for lease type.

significantly below expected local demand, including apparel stores and furniture and appliance stores. These categories represent potential opportunities to generate additional retail activity in Morgan Hill even while other categories may be saturated.

Visitor-Serving Commercial

The Morgan Hill area's wine industry, destination sports facilities, and local restaurants draw visitors from the surrounding region. In particular, Morgan Hill benefits from the attraction of visitors to the City's sports facilities, especially on weekends. Morgan Hill also has an opportunity to serve as a hub for visitor activity centered on the many wineries located in the agricultural areas surrounding the City. Although Morgan Hill is an easy day trip from most locations in the greater Bay Area, the City can maximize the benefits of its visitor attraction by encouraging visitors to spend the night, which will spur expenditures on lodging, restaurants, and retail.

Information received through the General Plan stakeholder interview process suggests that Morgan Hill's hotels are often booked to capacity on weekends and some weeknights when the sports facilities host large events that attract out of town participants and their families. The City's regional sports facilities attract 1.3 million visitors per year.¹² In addition, stakeholders indicated that as the number of fine-dining establishments in Downtown Morgan Hill has increased, the attraction of patrons from out of town has also increased. As mentioned above, the numerous wineries located near Morgan Hill help the City stand out as a logical location for lodging and other services to cater to these visitors. There is increased interest in healthy eating and fresh, natural, locally-produced foods, and Morgan Hill is well-positioned to capitalize on this trend and serve as a hub for people exploring the area. Morgan Hill can enhance its position by working with area wineries, restaurants, and farm stands to promote the area as a destination for agri-tourism.

These trends suggest that Morgan Hill has an opportunity to become more of a visitor destination, and that concerted efforts to attract additional visitors can pay off in the form of increased hotel, restaurant, and retail sales, provided that appropriate offerings are provided within the City to cater to visitors. The City could focus its visitor attraction efforts in two ways, including development of traveler-oriented commercial facilities (i.e. hotels, restaurants, auto services) near the City's freeway interchanges, and in developing the Downtown as a

¹² Visitor counts for the regional sports facility are cited in the Morgan Hill "Funstyle" publication available on the City's website (<http://www.morgan-hill.ca.gov/DocumentCenter/Home/View/6136>, accessed March 26, 2013).

dining, entertainment, and specialty retail location. This type of Downtown activity could also be complemented with a boutique hotel and bed and breakfast (B&B) establishments that would cater to wine tourists during the weekend, as well as travelers who are doing business in Morgan Hill during the week. Enhancing connections between the City's Sports Center, Aquatic Center, and Recreation Center could further support Downtown as a regional destination.

Residential

Residential real estate market conditions in Morgan Hill are discussed in the Population and Housing white paper.

Competitiveness of City Fees for Commercial Development

The cost of fees for development projects can affect business owners' decisions about where to locate. The City of San Jose prepared the 2010-2011 Bay Area Cost of Development Survey, and provided comparisons of development fees for several different types of projects in a number of jurisdictions, including Morgan Hill, San Jose, Santa Clara County, Palo Alto, San Mateo, and Sunnyvale. Among other development project types, the survey included a comparison of fees for tenant improvements in a 10,000 square foot commercial building, and fees for construction of a new 100,000 square foot R&D building. The costs included "development taxes", "impact/capacity fees" and "service fees".

According to San Jose's survey, Morgan Hill was very competitive in the cost comparison for the commercial tenant improvement project, with a total cost of \$7,130, which was the lowest of all six jurisdictions surveyed, and more than \$2,000 below Santa Clara County, which was second lowest. San Jose's total was \$20,733, and the highest was San Mateo at \$21,370. For the R&D building construction project, Morgan Hill's costs were in the middle of the group, at \$759,554. Palo Alto was highest, at \$2,321,783, followed by San Mateo, at \$926,207. San Jose's cost was \$448,187.

Potential Absorption

The General Plan Update process will include an evaluation of potential land use alternatives for Morgan Hill and consideration of suitable locations and quantities for office, industrial/R&D, and retail development in the City. Based on the information on real estate market conditions discussed in the sections above, current market conditions may not be conducive to new commercial development in the near term due to existing vacancies and low rents. However, as conditions change over the General Plan time horizon, the potential for commercial development in Morgan Hill is likely to improve. The following sections are intended to inform the development and evaluation of

land use alternatives by estimating the demand for commercial land uses during the General Plan horizon of 2035, which will provide insight regarding the potential absorption of new commercial real estate.

Retail

As discussed in the previous section, many professionals familiar with the retail environment in Morgan Hill report that the City is oversupplied with retail space for a city of its size. Although there are gaps in the existing retail offerings in Morgan Hill, Morgan Hill itself does not have the “critical mass” necessary for substantial additional retail development. The presence of most major competitors in either San Jose to the north and Gilroy to the south precludes shopper attraction to Morgan Hill from those cities, and limits the ability of Morgan Hill to achieve that critical mass necessary for additional retail in the City. In addition, the geographic and population constraints in and around Morgan Hill limit the retail trade area due to mostly undeveloped hillsides to the east and west, open space to the north, and low density development to the south. This suggests that existing leakage cannot necessarily be addressed by adding additional retail development to the Morgan Hill market.

Instead, retail opportunities in Morgan Hill will rely on rehabilitating and repurposing existing retail centers to make them more attractive to potential retailers. In some cases, retail opportunities may be enhanced by relocating existing retailers from less competitive retail locations to locations where there is better potential to achieve synergy between retail outlets. This could include redevelopment of aging existing centers such as Morgan Hill Plaza, at the southern edge of the Downtown, as horizontal or limited vertical mixed use, which might incorporate residential or small office uses along with retail. The economic feasibility of redevelopment of existing centers will depend on numerous factors particular to each property, and is likely to improve overall as the real estate market recovers over the course of the General Plan time horizon. One opportunity to shift retail development to better serve the community’s long-term needs might involve developing some neighborhood retail on the east side of Highway 101, to provide more convenient shopping for new residents in the eastern part of the City, particularly from development of hundreds of residences in San Sebastian. Rather than substantial net new square footage, retail opportunities in Morgan Hill during the General Plan horizon will most likely involve creative use of retail space that builds on the City’s existing assets, including wineries, agritourism, and the City sports facilities. One exception to this is the near term opportunity for additional growth in the auto sales sector, due to the success of the City’s two existing dealerships and the rebound in auto sales during the economic recovery.

General Plan Opportunities – Retail

The General Plan’s primary goals should be to fine tune Morgan Hill’s existing retail mix, optimize the location and arrangement of retail centers around the City, and allow for limited strategic retail growth. Because of Morgan Hill’s position between strong retail concentrations in San Jose and Gilroy, the City does not have a very large secondary trade area from which to draw shoppers for regional/destination shopping. Residents of San Jose and communities to the north, and residents of Gilroy and communities to the south can meet these needs closer to home without traveling to Morgan Hill. As a result, demand for most of Morgan Hill’s retail establishments is constrained by the size of the local population and the City’s position in between San Jose and Gilroy. While incremental population growth consistent with past trends will help to bolster demand for existing retail development, the City is unlikely to attract substantial numbers of new retail tenants unless the population increases to a substantially larger size, such as closer to 100,000 residents. At that population, certain retail types that are not already located in Morgan Hill, such as a discount membership club (e.g. Costco), may begin to look at the City. With that said, according to stakeholders interviewed as part of the Morgan Hill 2035 public outreach process, there appears to be an immediate opportunity for auto dealership expansion onto existing available land. This opportunity is driven by the success of the existing Ford and Honda dealerships, combined with a rebound in the new auto sales industry as part of the overall economic recovery. There may also be potential to consolidate existing retail into the stronger shopping centers and the Downtown area to develop greater critical mass and synergies among uses. The General Plan should consider providing better convenience-oriented neighborhood shopping in the eastern side of the City, so residents on that side of Highway 101 do not have to cross the freeway to meet basic everyday shopping needs. Such a facility would likely be in the range of 100,000 square feet of retail floor area.

Beyond market opportunities created from growth in resident demand, Morgan Hill has two other opportunities for retail growth. The first is to capture demand for freeway-oriented commercial development. This could include new lodging, restaurants, and retail facilities that would capitalize on growing traffic on Highway 101, as well as visitors to Morgan Hill itself, and high occupancy rates in existing lodging facilities. The City could seek to maximize the utilization of its freeway-visible commercial sites that also have good freeway ingress and egress for this purpose. The second opportunity for growth is for Morgan Hill to position its Downtown as a visitor destination, as well as a focal point for local residents. This could include additional restaurants, boutique retail and services, entertainment, and lodging.

Office

The 2012 Industrial Land Study projected demand for 805,000 to 2,052,000 square feet of office, industrial, warehousing, and R&D space between 2012 and 2030. These estimated ranges were based on ABAG 2040 employment growth targets for Morgan Hill from the May 2012 Jobs-Housing Connection Strategy and historic employment growth rates, incorporating assumptions about square footage per employee for each building type. The Study found that available land for office, industrial, warehouse, and R&D space exceeded the supply needed to accommodate demand within this range.

According to the Industrial Land Study, demand for office space in particular will range from 168,000 to 482,000 square feet between 2012 and 2030, at an annual average rate of 9,400 to 26,800 square feet of office space per year. As shown in Table 1-9, projecting this rate forward yields a total of 188,000 to 536,000 square feet of office space during the General Plan time horizon (2015-2035).

TABLE 1-9 **POTENTIAL OFFICE ABSORPTION, MORGAN HILL, 2015-2035**

	Low End Estimate (SF)	High End Estimate (SF)
Average Annual Building Demand ^a	9,400	26,800
Total Office Demand, 2015-2035	188,000	536,000

^a Low and high average annual building demand estimates are from the Industrial Land Study completed by Strategic Economics, September 2012.

Source: Strategic Economics, 2012; BAE, 2013.

Although the current high office vacancy rates and low office lease rates in the Morgan Hill/Gilroy submarket indicate a lack of demand for new office development in the short term, these projections suggest that demand will increase as the economy improves, particularly as high rents and low vacancies in other parts of Silicon Valley begin to push potential office tenants to Morgan Hill and other areas that are not perceived to be primary Silicon Valley submarkets. A portion of this demand is likely to be accommodated in existing vacant office space, while new development will provide additional square footage and replace existing office spaces that have become obsolete.

General Plan Opportunities – Office

Opportunities for office development are grouped below together with implications for Industrial/Warehouse/R&D.

Industrial, Warehouse, and R&D

The Industrial Land Study projects the average annual demand for industrial, warehouse, and R&D space between 2012 and 2030 as follows:

- 17,300 to 41,300 square feet of industrial space,
- 11,100 to 26,400 square feet of warehousing space,
- 7,000 to 19,500 square feet of R&D space.

The figures in Table 1-10 apply these annual average rates to the 20-year General Plan timeframe. As shown, estimated total demand between 2015 and 2035 ranges from 346,000 to 826,000 square feet of industrial space, 222,000 to 528,000 square feet of warehousing space, and 140,000 to 390,000 square feet of R&D space.

TABLE 1-10 POTENTIAL INDUSTRIAL, WAREHOUSE, AND R&D ABSORPTION, MORGAN HILL, 2015-2035

	Low End Estimate (SF)	High End Estimate (SF)
Industrial		
Average Annual Building Demand ^a	17,300	41,300
Total Industrial Demand, 2015-2035	346,000	826,000
Warehouse		
Average Annual Building Demand ^a	11,100	26,400
Total Warehouse Demand, 2015-2035	222,000	528,000
R&D		
Average Annual Building Demand ^a	7,000	19,500
Total R&D Demand, 2015-2035	140,000	390,000

^a Low and high average annual building demand estimates are from the Industrial Land Study completed by Strategic Economics, September 2012.
 Source: Strategic Economics, 2012; BAE, 2013.

As noted above, the Study also found that Morgan Hill currently has more vacant land designated for office, industrial, warehouse, and R&D space than is needed to meet projected demand.

Similar to the office market, demand for industrial, warehouse, and R&D space will follow trends in prime Silicon Valley markets. Discussions with real estate stakeholders indicate that, at present, economic conditions are such that it is

not feasible for developers to construct new industrial, warehouse, or R&D facilities in Morgan Hill. However, as high rents and low vacancies in Cupertino, Palo Alto, Mountain View, and other major Silicon Valley employment nodes push employers to other submarkets within Silicon Valley, demand for these space types will increase in secondary and tertiary markets, including Morgan Hill, and higher rents and values for finished projects will again lead to new construction in Morgan Hill.

General Plan Opportunities - Office, Industrial, R&D

For growth in Morgan Hill's primary job-generating land use categories, Morgan Hill is less competitively positioned than much of the rest of Santa Clara County/Silicon Valley, and trends in Silicon Valley tend to impact Morgan Hill later or to a lesser degree than the rest of the Valley. Land use alternatives should be developed with consideration of the City's location with respect to Silicon Valley and Santa Clara County. Land availability is not an issue for addressing retail, office, and industrial demand; instead, the General Plan's important challenges will be how to most efficiently use the City's available land and to establish policies and programs that will enhance the City's competitiveness within the larger regional market area.

Projected employment growth in Morgan Hill indicates demand for additional space during the General Plan horizon, but demand is not expected to exceed the amount that can be accommodated on vacant or under-utilized land currently zoned for these uses. As a location that is peripheral to the greater Silicon Valley market, Morgan Hill competes on the strength of its quality of life and competitive pricing relative to locations further to the north. It will be important that the City maintain a supply of buildable land to accommodate expansion of existing businesses and establishment of new office, industrial, and R&D. Recognizing that these facilities will compete for tenants with locations throughout Silicon Valley, a key advantage would be the availability of sites with good freeway access and visibility. Locations in the northern part of the City will likely be most favored. In addition, recognizing the importance of alternative transportation access to growing numbers of employees, the City should strive to organize office, industrial, and R&D development so that it is best positioned to take advantage of commuter rail service, either through proximity to the Caltrain station, or by clustering uses so that transit linkages might be provided efficiently.

The City should seek opportunities to bolster its competitiveness for employment-generating uses by:

- Ensuring that its impact fees for new development are as competitive as possible, while ensuring that the City has the resources to maintain public services, infrastructure, and a high quality of life as the community grows.

The City’s development fee structure should be considered in the context of the overall cost of development, including land costs and construction costs, in determining competitiveness.

- Streamlining development regulations and permitting processes so that desired business types can be permitted with minimal time and uncertainty.
- Developing a range of housing types that will accommodate workforce housing needs, in particular, market-rate rentals.
- Updating the zoning code to better recognize contemporary business types and needs.
- Protecting and enhancing the quality of the City’s business parks.

In addition, given that some degree of cross-commuting is expected to continue, as workers leave Morgan Hill to work farther north and employees drive from the south to work in Morgan Hill, the General Plan Update should seek opportunities to improve accessibility to and from Morgan Hill.

Mixed Use

The General Plan Update will address the geographic distribution of development throughout Morgan Hill, including the location of mixed-use development. Throughout the Bay Area, many jurisdictions are planning for mixed-use neighborhoods with residential, retail, entertainment, and employment uses, which is likely to drive the future distribution of land uses in Morgan Hill and elsewhere. There has been some mixed-use development in Morgan Hill in recent years, such as Harvest Plaza at the East Dunne Avenue exit of Highway 101, which has ground floor retail space and second-story office space. Harvest Plaza is an example of vertical mixed-use development, meaning that a single building contains multiple real estate product types. Mixed use development can also be horizontal, meaning that multiple real estate product types are included within a defined development area, but potentially in separate buildings. Given current market conditions in Morgan Hill, horizontal mixed-use development is likely to be more financially feasible than vertical mixed-use development during at least the early part of the General Plan horizon.

General Plan Opportunities – Mixed Use

Financial feasibility will be a challenge for mixed-use projects due to the greater construction costs and greater complexity of the project development process compared to single-use projects. In the short term, the City could focus on encouraging development of compact neighborhoods and districts, with horizontal mixed use where appropriate. Vertical mixed use should be targeted

for locations that are best situated to accommodate higher density development and the “urban-oriented” tenants and residents who would be most likely to occupy them. This means focusing on areas where there are good public amenities (e.g. parks, public gathering places, recreational facilities, libraries, and other community facilities), as well as attractive restaurants, shopping, arts/cultural venues, and easy access to transportation and jobs. Locations such as the Downtown area are likely to be among the first in Morgan Hill to support extensive mixed-use development as economic conditions improve. In the meantime, the City should be mindful of opportunities to encourage other projects or improvements (i.e. amenities) that will help to create the type of environment that will be conducive to mixed-use development.

City Fiscal Conditions

Municipal budget discussions often focus on the discretionary General Fund, the portion of the budget that is financed by unrestricted revenues that can be allocated according to a City’s needs and priorities. Although municipal budgets consist of multiple funds, the General Fund is Morgan Hill’s primary funding source for the provision of municipal services and is the fund that accounts for the largest portion of the municipal budget. The fiscal year (FY) 2013-14 budget for the City of Morgan Hill includes \$31.6 million in expenditures from the City’s General Fund. These funds are used to provide a number of services within the City, including police and fire protection services and street and park maintenance. The City also performs a range of administrative functions such as planning, human resources functions, and finance and accounting, much of which is financed the by General Fund. Along with operating expenses, the City’s budget, through Capital Improvement Program (CIP) funds, accounts for major capital improvement projects that the City is undertaking or planning during upcoming fiscal years.

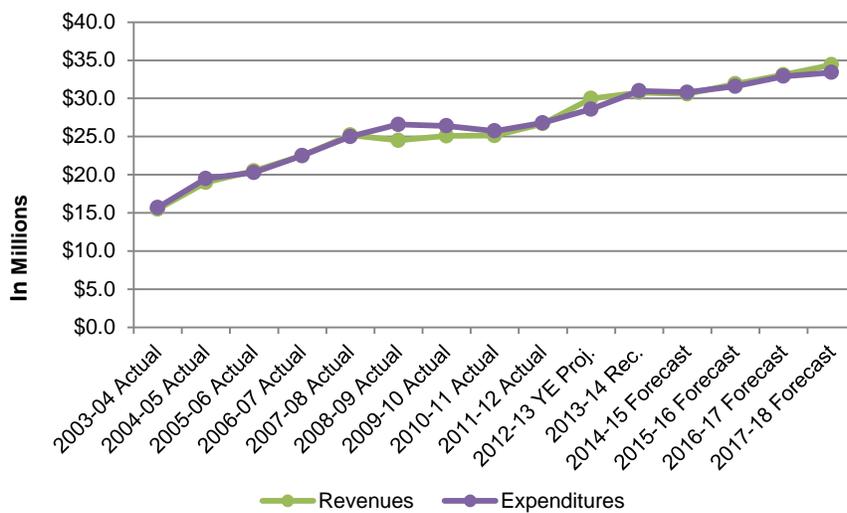
In recent years, the City’s budget has been impacted both by the recession, which has led to an overall decrease in General Fund revenues, and the loss of the City’s Redevelopment Agency following the statewide dissolution of Redevelopment. Although Redevelopment Agency funds did not contribute to the City’s General Fund, the City must now find ways to finance projects and services that were previously financed by Redevelopment, in some cases by drawing from the City’s General Fund, which ultimately impacts the total General Fund revenue available for other projects and services. Budgets from previous fiscal years used Redevelopment funds to perform maintenance functions Downtown, but these activities now need to be funded by public/private partnerships, be absorbed by the General Fund, or go unfunded.

Morgan Hill is noted for providing a range of high quality services and amenities for local residents. For the City’s sports facilities and recreational

programs in particular, Morgan Hill has been very successful in developing partnerships with non-profit organizations to deliver high quality services. This includes the City’s partnership with the Mt. Madonna YMCA for the operation of the City’s aquatic center, and the partnership with the Morgan Hill Youth Sports Alliance for the operation of the City’s sports complex. Maintaining the quality of these services as the City continues to grow will depend on the ability to expand partnerships such as these; otherwise, more of a financial burden will likely be placed on the City General Fund. In turn, this may require compromises in order to ensure a balanced budget.

Figure 1-5 shows General Fund revenues and expenditures for the City of Morgan Hill in FY 2003-04 through FY 2017-18. Revenues and expenditures in the later fiscal years are proposed budget figures or projected. As shown, revenue dropped below expenditures in FY 2008-09, reflecting the effects of the recession on the municipal budget. In FY 2009-10 and 2010-11, expenditures decreased while revenues increased, almost bringing expenditures in line with revenues. Both revenues and expenditures increased in FY 2011-12, and again in 2012-2013, with expenditures slightly above revenues. In FY 2012-2013, the year-end projection calls for revenues to slightly exceed expenditures; however, the proposed FY 2013-2014 budget anticipates revenues slightly lagging expenditures again in both FY 2013-2014 and FY 2014-2015. The budget forecasts for FY 2015-2016 through FY 2017-2018 call for a slight budget surplus each year, with both revenues and expenditures rising gradually.

Figure 1-5 General Fund Revenues and Expenditures, FY 2003-04 to FY 2017-18



Sources: City of Morgan Hill FY 2013-2014 Proposed Budget; BAE, 2013.

The City of Morgan Hill reestablished its fire department in January 2013. Rather than having City personnel, the city contracts with Cal FIRE for fire protection and emergency medical services (EMS).

By re-establishing the fire department and contracting with Cal FIRE, the City's General Fund will save approximately \$800,000 annually.

General Fund Revenues

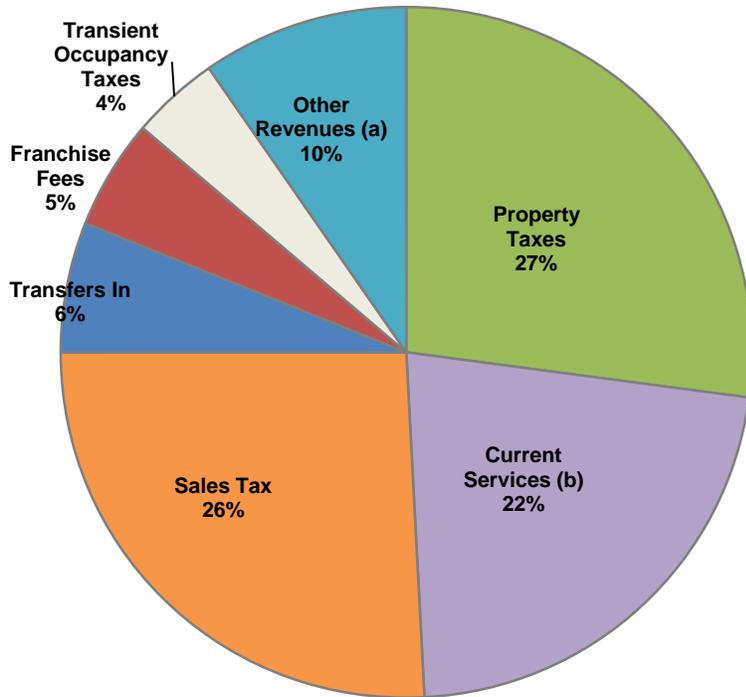
The City of Morgan Hill proposed FY 2013-14 Budget projects that General Fund revenues in the current fiscal year will total \$30.8 million, the majority of which will come from taxes and fees for service. Property and sales taxes comprise a significant portion of the City's General Fund revenue and are projected to generate \$8.4 million and \$8.0 million in General Fund revenues, respectively, during FY 2013-14. According to the Budget, and consistent with the taxable retail sales data shown in Figure 1-2, the transportation sector generates the largest amount of sales tax in Morgan Hill, due primarily to the two large automobile dealerships in the City and gas stations that serve commuters traveling through the City on Highway 101. Franchise fees are projected to generate an additional \$1.6 million to the City's General Fund.¹³ Additional revenue is supplied by the City's transient occupancy tax (TOT), which is charged to all 19 hotels within the City limits at a rate of 10 percent of room sales and is projected to generate a total of \$1.3 million in General Fund revenue in FY 2013-14. This 5 percent annual increase comes after a 4 percent increase in TOT revenues in 2010-2011, followed by a 19 percent increase in 2011-2012, and an 8 percent increase projected for 2012-14. During this time, lodging operators and the City benefitted from both improving room occupancy rates and increased average daily room rates. Figure 1-6 shows net discretionary General Fund revenues by source for FY 2013-14.

A substantial non-General Fund revenues are generated by fees charged for particular services. Much of the Community Services budget, which includes the cost of providing parks and recreational facilities, is paid for through fees paid by individuals that participate in the City's recreational programs. Similarly, much of the City's budget for development services is funded through charges for service, which include development application fees, plan check fees, and fees associated with the Residential Development Control System. Although the Planning Division fees do not result in full cost-recovery for Planning Division services because there are many non-fee related services

¹³ Franchise fees are paid by utilities to local governments in exchange for the right to provide service within a community.

that Planning provides that cannot be recouped, such as time assisting the public at the counter and over the phone.

Figure 1-6 Net Discretionary General Fund Revenues, City of Morgan Hill, 2012-13 Fiscal Year



^a Other revenues include CCC/Gavilan Rent, other rentals, Motor Vehicle In-Lieu fee, revenue from other agencies, Public Safety Sales Tax, Property Transfer Tax, Licenses, Permits, Fines, penalties, and miscellaneous revenues. Other revenue items each comprise 0.2 percent to 3 percent of total General Fund revenues.

^b Current services revenues are from charges collected from users of City services, who are charged a fee that is designed to recover the City's cost of providing the service. This can include, but is not limited to, recreation fees and charges for services such as planning applications.

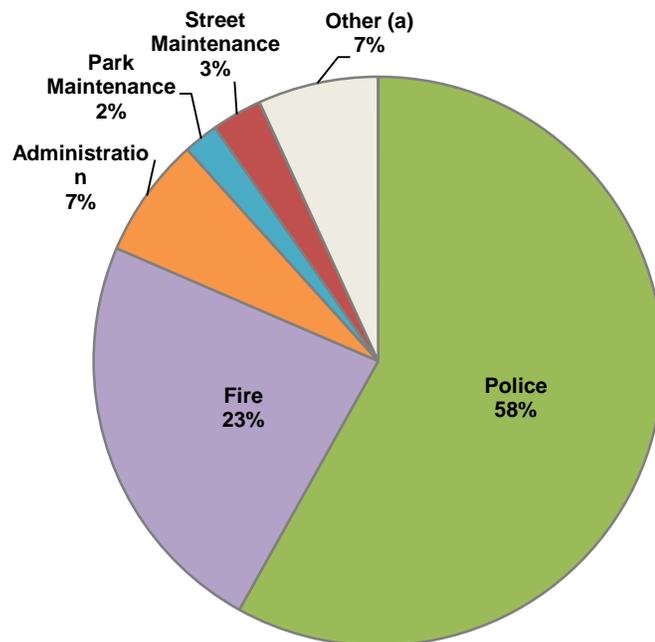
Sources: City of Morgan Hill FY 2013-2014 Proposed Budget; BAE, 2013.

General Fund Expenditures

The FY 2013-14 budget shows \$31.6 million in total discretionary General Fund expenditures and \$21.0 million in discretionary General Fund expenditures net of department revenues and transfers in. More than half (58.1 percent) of discretionary General Fund expenditures were budgeted to support the Police Department, which has a FY 2013-15 discretionary General fund

budget of \$12.2 million net of departmental revenues and transfers in. Almost one fourth (23.4 percent) of discretionary General Fund expenditures were budgeted to pay for the City’s contract with Cal FIRE, which was projected to have a net cost of \$4.9 million, down from about \$5.5 million in FY 2012-2013, due to the new contract with Cal FIRE, in place of services previously provided by Santa Clara County Central Fire Protection District. The FY 2013-14 budget appropriates 6.8 percent of discretionary General Fund expenditures (\$1.4 million) to the City’s Administration Department. The remaining 12 percent of the City’s net discretionary General Fund expenditures is split between Park Maintenance, Street Maintenance, Hall/El Toro Youth Center, Congestion Management, Community Development, Downtown Maintenance, Environmental Programs, Recreation and Community Services, and Future Replacement- Old City Hall. A few of these items have large total budgets but a relatively small net impact on the discretionary General Fund because costs are covered primarily by departmental revenues or transfers. Figure 1-7 shows net discretionary General Fund expenditures by use for FY 2013-14.

Figure 1-7 General Fund Expenditures, City of Morgan Hill, 2012-13 Fiscal Year



^a Other expenditures include Pavement Rehab CIP, Hall/El Toro Youth Center, Congestion Management, Community Development, Downtown Maintenance, Environmental programs, Recreation and Community Services, and Future Replacement – Old City Hall. Other expenditure items each comprise less than 1 percent of total discretionary General Fund Expenditures, except for Pavement Rehab CIP, which is 4.8 percent.

Sources: City of Morgan Hill FY 2013-2014 Proposed Budget; BAE, 2013.

General Plan Opportunities – Fiscal Health

When evaluating a proposed development program or land use change, cities often consider the potential impact of the project on municipal revenues and expenditures. New development often leads to an increase in some of the major sources of municipal revenue, particularly property and sales taxes. At the same time, new development is associated with an increase in residents, employees, or both, which increases the demand for municipal services, thereby requiring an increase in municipal expenditures, assuming that service levels are to remain consistent after build out of new development. Fiscal impact analysis determines how the revenues gained from new development compare to the cost of providing services to new development.

The fiscal impact of new development in Morgan Hill and other cities varies depending on the type of development considered. Certain development product types commonly generate sufficient revenue to cover the cost of providing service to new development. In particular, retail and lodging uses often generate additional revenues that have the potential to yield a fiscal surplus in particular due to sales tax revenues associated with retail development and transient occupancy tax revenues associated with lodging, in addition to property taxes and other revenues. However, any development product type has the potential to have either a positive or negative fiscal impact, depending on the specific project's unique revenue generating characteristics and its specific service needs. For example, where adequate service capacities may exist, the new development may not require a commensurate increase in service expenditures, which will help to produce positive fiscal outcomes.

Although project-specific information is required to estimate the net fiscal impact of any particular development plan, the following sections outline some of the ways in which office, research & development (R&D), industrial, retail, and residential development might impact municipal revenues and expenditures. The 2012 Industrial Land Study included an analysis of the potential fiscal impacts of rezoning two industrial sites to allow for residential uses, and provides a basis for some of the discussion in the following sections. The potential fiscal impact of various potential land uses in Morgan Hill will be evaluated in further detail in subsequent analysis related to the General Plan Update alternatives analysis, when revenues and service costs can be estimated based on potential development programs.

Office, R&D, and Industrial

Any new development is expected to generate an increase in municipal property tax revenues as vacant or underutilized parcels are developed with higher-value development, causing a reassessment of the property tax level for

that property. The extent to which retail, industrial, office, residential, or other development increases the property tax base depends on the difference between the assessed value of the new project and the assessed value of the project site prior to development.

The impact of office, R&D, or industrial development on sales tax revenue varies on a project-by-project basis. Employees often purchase taxable items close to work, thereby generating a small increase in sales tax revenue to the City. To the extent that office development has more workers per square foot than industrial development, the taxable sales revenues generated by office development are expected to be higher than those generated by industrial or R&D development. In addition to sales tax generation due to employee spending, many office, industrial, and R&D businesses generate business-to-business sales tax, a portion of which accrues to the City. The magnitude of this revenue source could vary widely depending on the specific business type.¹⁴

In some cases, office, R&D, or industrial development is associated with an increase in TOT resulting from visits spawned by business-related travel. More detailed analysis is needed to determine the likely magnitude of the impact of new office, industrial, or R&D development on TOT revenues in Morgan Hill. The City has noted that attendance at large events hosted at its sports facilities is a strong generator of hotel room bookings, particularly on weekends when business travel may be diminished.

Employees generated by new office, R&D, or industrial development would be expected to increase the demand for City services in Morgan Hill, thereby increasing municipal expenditures. However, in comparison to a resident, a local employee is conventionally estimated to have one-third to one-half of the impact on municipal services. Police and fire services, which make up the majority of the General Fund expenditures in the City, are among the municipal services most likely to be affected by an increase in development. According to the Industrial Land Study, however, increases in service population do not trigger an increase in costs under the City's contract with Cal FIRE, so new development is not likely to have a net fiscal impact on City expenditures for fire protection and EMS. In the scenarios analyzed in the Industrial Land Study, Police Department costs were the primary expenditure item associated with new development, representing 60 to 75 percent of the net

¹⁴ Business-to-business transactions are transactions between businesses, such as a sale from a building materials manufacturer to a contractor who is constructing a building, or sales of medical devices to a hospital. Business-to-business sales taxes are the taxes generated by these transactions that involve taxable goods.

increase in service costs. As noted above, it is not possible to make categorical conclusions about the likely overall cost/benefit fiscal impact of any development product type in Morgan Hill in general, including office, R&D, and industrial uses. For example, if placed in an infill location where there is existing service capacity such that new development does not trigger an increase in expenditures on major services (e.g. police and fire protection), even a development type that does not characteristically generate large amounts of new revenue (e.g. multifamily residential) might generate sufficient new revenues to be fiscally neutral or positive.

Retail

Similar to office, R&D, and industrial development, new retail development would be anticipated to generate an increase in property tax revenue to the City, assuming that the assessed value of new development is higher than the existing value of the sites that are developed. Like employees working in office, R&D, or industrial space, retail employees are likely to make some taxable purchases close to work, thereby increasing sales tax revenue to the City.

In addition to these fiscal benefits, retail development is typically assumed to lead to an overall increase in municipal sales tax revenue by providing additional retail options to residents and visitors. However, retail development can have this effect only if new retail development captures new sales within the City, rather than shifting existing sales from existing retail outlets in the City to new retail developments.

As with office, R&D, and industrial development, retail development would generate additional employees in Morgan Hill, thereby increasing the demand for City services, though to a lesser extent than residential development. Overall, it is not possible to make general conclusions about the likely fiscal impact of retail development in Morgan Hill, though development involving taxable retail sales will tend to be fiscally attractive.

Residential

As with commercial development, residential development is typically expected to increase a City's property tax revenues. As noted in the Industrial Land Study, residential development has a higher value per square foot than industrial development and therefore generates a larger increase in property tax revenue.

New residential development is also associated with an increase in municipal sales tax revenue, since new residents are likely to make purchases close to home. The magnitude of any increase in sales tax revenue to the City of Morgan Hill will depend largely on the retail offerings provided within the City

and the extent to which residents purchase taxable items within Morgan Hill rather than other cities. Nonetheless, Morgan Hill residents are likely to make more purchases within the City than are people who work in Morgan Hill and live elsewhere. Therefore, the increase in sales tax revenue resulting from new residents shopping locally can be expected to be larger than the increase resulting from new employees shopping locally.

New residential development also increases the demand for municipal services, which requires an increase in municipal expenditures, assuming that the City will maintain a relatively consistent level of service following new development. In comparison to an employee who works in the City, each resident is typically estimated to have two to three times the impact on municipal services, as noted in the previous sections.

Due to the comparatively high cost of service provision that is associated with new residents, residential development is often presumed to result in a negative net fiscal impact, meaning that the revenue generated from residential development is often insufficient to cover the cost of providing services to new residents. The findings from the fiscal analysis presented in the 2012 Industrial Land Study are somewhat in line with this assumption; industrial development on the sites considered was projected to lead to a net increase in General Fund revenue estimated at \$87,100 per year, while multifamily development was projected to lead to a net fiscal decrease in General Fund balance estimated at \$25,200 per year. However, single-family development was projected to have a positive net fiscal impact on the General Fund estimated at \$43,000, which, although less substantial than the estimated fiscal benefit of industrial development, indicates that the single-family development considered in the analysis could generate sufficient revenue to cover the costs associated with new residents.

There are other circumstances under which residential development may have a net positive fiscal impact for Morgan Hill. For example, if new residential development is located such that it falls within the fire department's existing response area, where new fire department equipment, staffing, or facilities would not be necessary, then the 29 percent of General Fund expenditures currently associated with Fire services may not change appreciably. This would mean that the new residential might be approximately 29 percent less expensive to serve, increasing the potential fiscal benefits of new development.

The General Plan will need to balance the concern with the fiscal impacts of new residential development, particularly new multifamily development, with the recognition that the availability of affordable workforce housing is an important economic development consideration. The City can use the General

Plan growth alternatives analysis process to understand the fiscal implications of different mixes of land uses, and ultimately to refine and select a preferred growth alternative that best balances fiscal and economic development considerations, among others.

Visitor-Serving Uses

Development of additional lodging (e.g., hotels and B&Bs) presents the opportunity for the City to increase revenues from transient occupancy taxes, in addition to property taxes paid by lodging property owners. In addition, when visitors are attracted to stay overnight in Morgan Hill lodging facilities, they are more likely to spend money in local retail establishments and restaurants, which will generate additional sales tax revenues. Although visitors do generate service demands, which can have cost implications, a visitor is not likely to create the same range of service demands as a resident.

Overall Fiscal Observations

Typically, fiscal impact analyses demonstrate that office, industrial, and retail development cause a larger positive net fiscal impact or smaller net fiscal deficit than residential development. However, there are indications that Morgan Hill could benefit from an increase in housing options because a greater range of housing options would help businesses to be more competitive to attract employees. This suggests that there are potential benefits stemming from residential development over time that might not be captured in a fiscal analysis that looks at residential development on a project-by-project basis.

Property taxes (and related property tax in-lieu of Vehicle License Fees) and sales taxes drive the City's General Fund revenues.¹⁵ However, in the case of retail sales taxes, the City's opportunities for increased revenues are largely limited by the amount of resident demand of the types of retailers that are attracted by the size of the City's residential base. Unless the City grows to about a 100,000 population size threshold, it is unlikely that Morgan Hill will

¹⁵ Beginning in FY2005-2006, the State ceased to provide "backfill" funds to counties and cities in the form of Motor Vehicle In-Lieu Fees (VLF) as it had through FY2004-2005. As a result of the complicated financial restructuring enacted as part of the State's budget balancing process, counties and cities now receive revenues from the State in the form of what is known as property tax in-lieu of vehicle license fees, or ILVLF. This State-funded revenue source is tied to a city's total assessed valuation. In FY2005-2006, former VLF revenues were swapped for ILVLF revenues, which set the local jurisdiction's ILVLF "base." The base increases each year thereafter in proportion to the increase in total assessed valuation within the jurisdiction. For example, if total assessed valuation increases by 5 percent from one year to the next, the ILVLF base and resulting revenues would increase by 5 percent.

attract additional categories of large-scale retailers that are not already well represented in the City or the surrounding regional market area. However, the expansion of auto sales is a near-term opportunity that could be pursued.

Retail sales catering to increases in visitors and freeway travelers represent an opportunity to stimulate additional revenues. Similarly, transient occupancy tax collected by lodging establishments is another opportunity for the City to increase revenues by catering to freeway travelers, people doing business with local companies, and visitors who are attracted to Morgan Hill's sports facilities and the surrounding wine-tourism opportunities. Building from the City's strong local demographics, there is an opportunity to develop additional restaurants, specialty retail, and higher end personal services in the Downtown area that will attract visitors as well as local residents. In addition to freeway-oriented lodging, a boutique hotel in the Downtown area, within walking distance of a concentration of fine dining and shopping, could be attractive to visitors to the wineries and agri-tourism opportunities in the surrounding area.

On the cost side, because of the structure of Morgan Hill's new fire services contract with Cal FIRE, the City has the opportunity to grow while incurring limited additional costs for fire protection services, which is one of the major General Fund cost components. To benefit in this way, it will be important for the City to consider where development occurs related to emergency response time from existing fire stations that protect Morgan Hill.

Looking forward through the General Plan horizon, the City will continue its efforts to bring in sufficient revenues to maintain the high public service standards to which the community is accustomed. Like other California communities, Morgan Hill has faced fiscal stress over the last five years in particular, due to a combination of the general economic recession and related State budget actions that have abolished Redevelopment and increased required contributions for employee pensions, among others. Like the vast majority of California communities, Morgan Hill has had to make budget adjustments to cope with these stresses. The lesson learned from this experience is that it will be important for the City to be vigilant about managing its long-term expenditure obligations, so that the City has as much flexibility as possible in the future to adjust to other unexpected fiscal challenges.

Morgan Hill's relatively good jobs housing balance indicates that the City has a reasonably balanced mix of existing land uses, including residential, retail, office, and industrial development such that the City enjoys a diversified revenue stream, which is not excessively dependent upon any one land use sector or revenue type. Continuing to plan for growth in a way that ensures a

diverse revenue base, from a diverse set of land uses, will help to solidify the City's fiscal position and ensure resilience in the event of further recessions or other unanticipated changes in economic circumstances. Morgan Hill 2035 will help the City plan for the optimum mix of new land uses to maintain and enhance Morgan Hill's quality of life, and facilitate fiscal sustainability and economic development within a compact land use pattern. This approach will take advantage of existing service capacities and otherwise limit the need to expand public service expenditures that will help to make the City as fiscally efficient as possible. Building upon the City's current success with provision of recreational facilities and programs through public/private or public/non-profit partnerships will also help support continued fiscal health.

A P P E N D I X A

E C O N O M I C S



Table A-1: Currently Leasing Office Properties, Morgan Hill, February 2013

Name/Address Stories/Year Built	Total Size Space for Lease Vacancy Rate	Asking Rent	Min Divisible Max Contiguous	Lease Type	Parking	Details
Tierra Vista 18525 Sutter Blvd 2 stories/Built 2002 	30,276 total sq. ft. 1,827 sq. ft. available 6% vacant	\$1.70/sf/mo	N/A	NNN	N/A	Class A property
Vineyard Office Building 275 Tennant Ave 2 stories/Built 1989 	19,247 total sq. ft. 9,163 sq. ft. available 48% vacant	\$1.35 to \$1.75/sf/mo	496 sq. ft. min. 3,723 sq. ft. max. 5 spaces available	Modified Gross	N/A	Class A property
18225 Serene Dr. 1 story/Built 1999 	52,272 total sq. ft. 5,772 sq. ft. available 11% vacant	\$1.25/sf/mo	N/A	Full Service	40 surface spaces	Office/R&D space Class B property Sublease - expires Aug 2013
Harvest Plaza 1295 E. Dunne Ave. 2 stories/Built 2006 	29,750 total sq. ft. 7,045 sq. ft. available 24% vacant	\$1.25/sf/mo	968 sq. ft. min. 2,307 sq. ft. max. 5 spaces available	NNN	N/A	Second story office space above ground-floor retail in community retail center. 5 office spaces and two retail spaces are available.
Coyote Creek Center 17015 Walnut Grove 1 story/Built 2000 	6,300 total sq. ft. 4,200 sq. ft. available 67% vacant	\$1.25/sf/mo	2 spaces available	NNN	Parking onsite with overflow available	Retail or office space.

Sources: Loopnet, 2013; BAE, 2013

Table A-2 Currently Leasing Industrial Properties, Morgan Hill, February 2013

Name/Address Stories/Year Built	Total Size Space for Lease Vacancy Rate	Asking Rent	Min Divisible Max Contiguous	Lease Type	Parking	Details
16550 Railroad Ave 1 story/Built 1989 	40,017 total sq. ft. 2,112 sq. ft. available 5% vacant	\$0.99/sf/mo	N/A	Industrial Gross	2.33 spaces/1,000 sq. ft.	Automotive/Industrial Unit. 2 grade-level doors, 14' ceiling height. Includes reception area and one office.
Dariono Properties 16120 Caputo Dr #G 1 story/Built 1988 	11,864 total sq. ft. 770 sq. ft. available 6% vacant	\$0.90/sf/mo	N/A	N/A	Parking on site.	Includes reception area and office. 16' ceiling height. Roll up door.
18434 Technology Dr 1 story/Built 1999 	9,883 total sq. ft. 8,000 sq. ft. available 81% vacant	\$1.05/sf/mo	N/A	NNN	26 spaces	Includes 2,500 sq. ft. of office. 18' ceiling height. 2 roll up doors
16080 Caputo Dr 1 story/Built 1984 	14,365 total sq. ft. 6,120 sq. ft. available 43% vacant	\$0.85/sf/mo	2,040 sq. ft. min. 6,120 sq. ft. max.	Full Service	2 spaces/1,000 sq. ft.	14' ceiling height. 2 grade-level doors. Includes office.
755 Jarvis Dr 2 stories/Built 1997 	257,296 total sq. ft. 240,400 sq. ft. available 93% vacant	\$0.69/sf/mo	2 spaces available	NNN	3.1 spaces/1,000 sq. ft.	30.16-acre lot. Includes office space. 4 dock-high doors. Full commercial kitchen, cafeteria, and on site volleyball and basketball areas.

Continued on following page

Table A-2: Currently Leasing Industrial Properties, Morgan Hill, February 2013 (continued)

<u>Name/Address</u> <u>Stories/Year Built</u>	<u>Total Size</u> <u>Space for Lease</u> <u>Vacancy Rate</u>	<u>Asking Rent</u>	<u>Min Divisible</u> <u>Max Contiguous</u>	<u>Lease Type</u>	<u>Parking</u>	<u>Details</u>
Adams Court Business Park 18855 Adams Ct. 2 1 story/Built 2004 	25,000 total sq. ft. 13,098 sq. ft. available 52% vacant	\$0.55/sf/mo	13,098 sq. ft. min. 25,000 sq. ft. max.	NNN	N/A	Building is also available for sale.
16875 Joleen Way 1 story/Built 2008 	25,600 total sq. ft. 2,000 sq. ft. available 8% vacant	\$1.00/sf/mo	N/A	Industrial Gross	5 spaces	Includes 300 sq. ft. of office. 1 grade-level door. 16' ceiling height.
220 Cochrane Circle 1 story/Built 1990 	46,380 total sq. ft. 46,380 sq. ft. available 100% vacant	\$0.75/sf/mo	N/A	NNN	2.55 spaces/1,000 sq. ft.	Freestanding industrial warehouse. 10 grade-level doors. Cafeteria, showers, lockers. Property is also for sale.
15500 Concord Circle 1 story/Built 1985 	28,875 total sq. ft. 21,539 sq. ft. available 75% vacant	\$0.65/sf/mo	N/A	Modified Gross	3 spaces/1,000 sq. ft.	Industrial manufacturing space. 5 grade-level doors, fenced yard. Available April 2013.

Sources: Loopnet, 2013; BAE, 2013

Table A-3: Currently Leasing Retail Properties, Morgan Hill, February 2013

Name/Address Stories/Year Built	Total Size Space for Lease Vacancy Rate	Asking Rent	Min Divisible Max Contiguous	Lease Type	Parking	Details
16315 Monterey Rd 1 story/Built 1946 	3,650 total sq. ft. 3,650 sq. ft. available 100% vacant	\$1.95/sf/mo	1,850 sq. ft. min. 3,650 sq. ft. max.	Full Service		Space includes one 1,850-sf office space for \$1.95/sf/mo and one 1,800-sf storage space for \$0.56/sf/mo. 30,000-sf fenced yard is also available.
Morgan Hill Plaza 16905-16999 Monterey Rd 1 story 	90,000 total sq. ft. 8,441 sq. ft. available 9% vacant	\$1/sf/mo	750 sq. ft. min. 1,115 sq. ft. max. 9 spaces available	NNN		Neighborhood shopping center anchored by Dollar Tree and Ross.
Cochrane Plaza 102-205 Cochrane Plaza 1 story 	250,000 total sq. ft. 48,951 sq. ft. available 20% vacant	\$0.99/sf/mo to \$2.25/sf/mo	1,050 sq. ft. min. 25,580 sq. ft. max. 12 spaces available	NNN	4.5 spaces/1,000 sq. ft.	Community shopping center anchored by Walmart, Big 5, and Hobby Lobby.
Harvest Plaza 1295 E. Dunne Ave. 2 stories/Built 2006 	29,750 total sq. ft. 3,085 sq. ft. available 10% vacant	\$1/sf/mo	968 sq. ft. min. 2,307 sq. ft. max. 2 spaces available	Modified Gross		Ground-floor retail space with second-story office in a community retail center. 5 office spaces and two retail spaces are available.
Cochrane Commons 1007 Cochrane Rd 1 story/Built 2008 	657,250 total sq. ft. 61,053 sq. ft. available 9% vacant	Negotiable	7,260 sq. ft. min. 35,053 sq. ft. max. 3 spaces available		4.1 spaces/1,000 sq. ft.	Property is in the first phase of an approved 657,250-sf center anchored by Target, Staples, Petco, and DSW.
Coyote Creek Center 17015 Walnut Grove 1 story/Built 2000 	6,300 total sq. ft. 4,200 sq. ft. available 67% vacant	\$1.25/sf/mo	2 spaces available	NNN	Parking onsite with overflow available	Retail or office space.

Sources: Loopnet, 2013; BAE, 2013