Arizona Leadership Institute

Policy Research on behalf of Workers and their Families

Los Arcos Town Center Proposal: Net Loss to Taxpayers While Wal-Mart and Ellman Profit

Developer Steve Ellman's proposal to build a "big box" center at the corner of McDowell and Scottsdale Roads at the former site of the Los Arcos Mall is expected to generate annual sales in the range of $200-225 million and provide $2.8 to $3.2 million in sales tax revenues to the city of Scottsdale based on projections from the city of Scottsdale, the Developer, and consultants Elliot D. Pollack and Company. The "big box" center will include a Wal-Mart Supercenter, Sam's Club (also owned by Wal-Mart) and Lowe's Home Improvement Center. In addition, it will include a gas station, small shops, and likely two fast food restaurants.

If pursued as proposed, the city of Scottsdale will see no net increase in local revenues, while collectively the adjoining cities of Tempe, Phoenix and Mesa will suffer sales tax revenue losses of approximately $1.5 million per year. Meanwhile, Ellman Companies and their largest tenant Wal-Mart stand to gain approximately $1.8 million annually in public subsidies.

The proposal is suspect on two grounds: economics and ethics. This report discusses these weaknesses, then provides additional details on the method used to achieve these estimates.

Economic Weakness:

On economic grounds Scottsdale argues that the reason behind offering sales tax sharing schemes with Developers of Regional Centers is to increase tax revenues. As stated in a recent White Paper for the Scottsdale City Council:

> The City of Scottsdale set the model for the structure of sales tax rebate investments for metro area communities. Most of the municipalities in the Phoenix metro area have engaged in offering incentives to retailers using Scottsdale's model. The reasons why are the city reaps new sales tax revenues that would not otherwise be recognized, even if they are at a reduced level for the first few years (versus no revenues).[1]

While we find 60% of the sales tax revenues on this project are "new sales tax revenues that would not be otherwise recognized," the combination of a generous sales tax rebate (49%) and a tax reductions due to a $1 a year lease for a parking garage lead Scottsdale to gain no new revenues.

However, the bulk of those sales tax revenues aren't really "new" but transferred from Phoenix, Tempe and Mesa (the remainder come from the Salt River Pima Maricopa Indian Community). So Scottsdale is paying Ellman Companies to buy sales tax revenues from adjoining communities—but ultimately not receiving any new tax money. Taxpayers will be ripped off.

Ethical Weakness:

By subsidizing retailers in a competitive market, the city of Scottsdale is picking winners, rather than allowing consumers to do so. Certainly consumers within the immediate neighborhoods around the proposed Los Arcos Town Center will find the location of these new "big box" retailers convenient, as such many residents will chose to spend their incomes there, rather than travel farther away. Customers are willing to pay for this advantage by paying more for items due to the added convenience. At Wal-Mart many customers find not only convenience, but lower prices, increasing its competitive advantage versus other outlets.

However, this should normally be a matter of consumer choice, not government choice. Instead we have the city of Scottsdale choosing a winner in what will become a saturated neighborhood market due to the size of the project. Wal-Mart through a Supercenter and Sam's Club will occupy 2/3 of the space in the proposed Los Arcos Town Center. As such Scottsdale is aiding Wal-Mart in their strategy to eliminate a major competitor in the Discount Department Store Market, K-Mart, as well as putting Wal-Mart in a favorable position as they pursue their aim to lead Arizona in grocery market share as well.[2]

Wal-Mart has aggressively used its perceived competitive advantage by placing new stores in close proximity to existing K-Marts. Los Arcos Town Center is another example of this placement. The market region for this center is landlocked and not growing, so retailers are fighting over an existing number of consumers, not a growing number of consumers. A K-Mart at Hayden and McDowell is only one mile from the proposed Wal-Mart Supercenter. We can expect K-Mart to take a big hit on its current sales. As K-Mart is rapidly closing stores that fail to turn a profit, we should not be surprised to find K-Mart closing with much of their customer base taken by Wal-Mart. While this result can occur in a competitive market, in this case the huge subsidy offered by the city of Scottsdale is placing Wal-Mart at an unfair advantage.

Likewise, there are three supermarkets within one mile of the proposed Los Arcos Town Center: an Albertson's (SW corner Thomas and Scottsdale Road), Basha's (SW corner Miller and McDowell), and Fry's (NE corner Miller and McDowell). A supermarket's customer base is almost exclusively drawn from a 2-3 mile radius. The addition of a fourth supermarket option here will have dramatic effects on the existing supermarkets. It's quite likely one of these existing outlets will be forced to close. Again the city subsidies granted Wal-Mart put the city, rather than the marketplace, in the place of picking winners.

If a city is going to pick winners, their choices should be consistent with their ethical values. Cities might favor companies that pay higher wages and benefits or are leaders in community development. The city choosing Wal-Mart as the winner raises additional ethical concerns. Wal-Mart is currently facing a mammoth gender discrimination class action lawsuit.[3] The city of Scottsdale does not condone gender discrimination; however, by granting Wal-Mart this subsidy, the city would be implicitly endorsing Wal-Mart's apparent gender discrimination practices.

In addition, one of Wal-Mart's "competitive" advantages is that they pay their workers less than their competitors.[4] While no study has been done in Arizona, a recent study in Washington state found that Wal-Mart employees were the biggest employer-based users of the subsidized public health system for the poor.[5] Hence, by insufficiently compensating employees who end up relying on the taxpayer financed health system, Wal-Mart indirectly received a taxpayer subsidy, which Wal-Mart turns into private profits.

Background:

In Arizona cities frequently compete for retail centers with subsidies due to the sales tax revenues which they will generate. Unfortunately, while individual cities see this behavior as rational, for the region as a whole they are counterproductive. Essentially cities pay retailers and developers to capture sales tax revenues from other cities who then respond in kind. Retailers and developers come out ahead, but taxpayers lose.

Los Arcos redevelopment is an example of in-fill development in an established neighborhood. This region exists largely of established homes in a landlocked area. As a result, the development does not serve a growth in demand so much as existing demand. The proposed stores will likely be convenient for those living nearby and surveys commissioned by the Developer have suggested that they are popular—largely due to limited retail in the immediate area.[6]

Retail is not the only way to bring tax money and improved retail to this area. Other possibilities would be high density residential uses which would increase local demand for retail uses. Likewise, an employment or service (education) center would bring people into the region who would also demand services. Or some combination of retail, residence and employment could be explored.

This particular project focuses on retail and aims to redistribute existing demand and pull in customers from outside Scottsdale. The Los Arcos proposal caught broader attention due to the large size and duration of the subsidy. If passed as proposed, it will be the largest subsidy in Scottsdale's history and the second largest in the state, surpassed only by Chandler's subsidy to Westcor to build Chandler Fashion Square.

The subsidy comes in two forms. Forty-nine percent of sales tax revenues are rebated back to the Developer (and presumably shared with tenants through below market rents) for 40 years. In addition, the Developer will be building a parking garage on the premises, which will be given to the city then leased back to the Developer for $1 per year. The lease-back arrangement means the Developer will pay a per parking space tax, rather than a property tax on the parking garage, leading to additional tax savings for the Developer and lost revenue to the city.

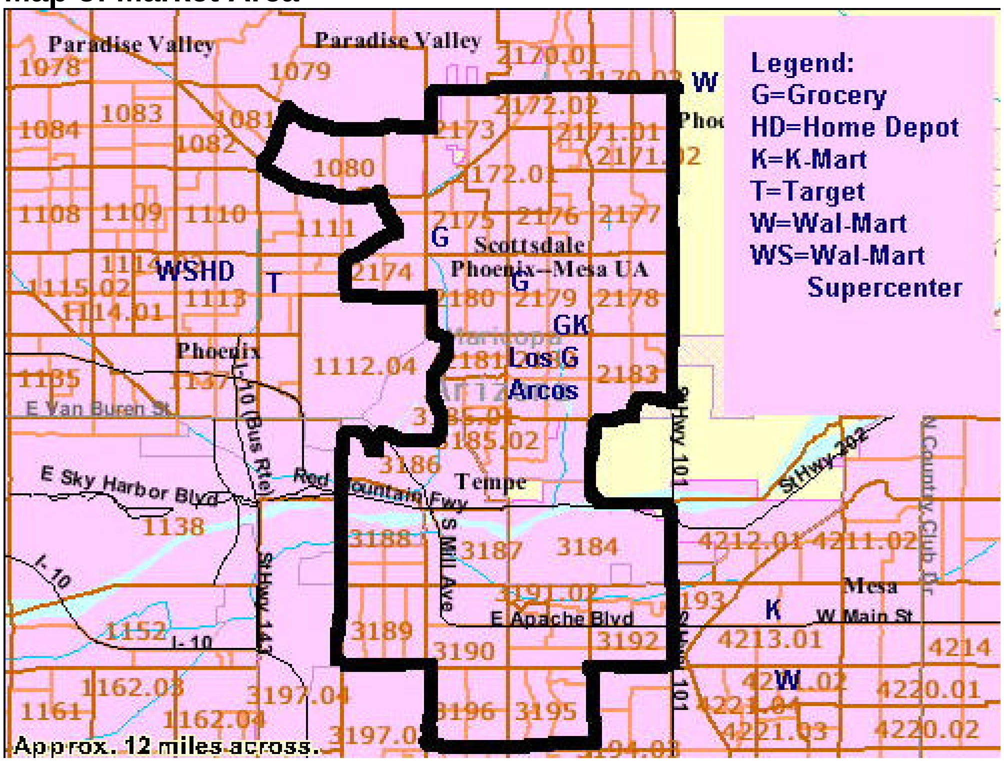
Methodology:

Existing economic impact studies fail to consider impacts on the local economy. Instead they focus only on the sales and sales tax revenues generated from the proposed project. Such results are misleading, because such projects do not happen in a vacuum, especially a project like this in a well-established older neighborhood.

The project is likely to be successful with no subsidy due to the relative dearth of retail in close proximity to this project. K-Mart is the only major retailer within 2 miles. In addition, the three "big box" retailers will benefit from their close proximity to each other. The area is already well served by grocery stores. Home improvement warehouses have a much larger market base. The inclusion of Lowe's represents an efforts by Lowe's to cut into Home Depot's market which currently serves the area—though many items available at these warehouse stores are also available at other locations in Scottsdale.

The potential market for the Los Arcos "big box" center project was examined through 26 census tracts extending from Camelback and 48th Street and then along the north to Chaparral to Pima Road. Customers farther north would most likely opt for Scottsdale Pavilion and an alternative Wal-Mart and Target stores.

Map of Market Area



To the south we explored as far west as Ash and Southern in Tempe and as far east as Southern and McClintock and then angled up to Broadway and Price. The customer base beyond this area we expect to be minuscule.

Within each census tract we examined its population, percent of population aged 15-24 (census tract age range used to estimate college students), and the percent of rentals to give a relative consumer weight for each.

We consider three sectors: Home Improvement, General Retail, and Groceries.

For Home Improvement, we assume renters are half as likely to spend money as homeowners. We also assume that college age students are less likely to frequent home improvement centers. For General Retail we assume all are equally likely to purchase regardless of income or age—especially since Wal-Mart typically caters to a lower income demographic. For groceries, we assume all spend equally except for college-age students who are more likely to eat out or on campus and spend somewhat less.

Using these factors we estimate the current spending habits by virtue of the degree of spending occurring in Scottsdale in each of these three sectors for each census tract. We then do a revised estimate based on the assumption of a "big box" center at Los Arcos. The initial numbers are less important than the changes that take place after development.

In addition, we make an effort to determine what portion of the demand for the Los Arcos Town Center comes from existing merchants in Scottsdale and what portion comes stores outside Scottsdale. Based on the dynamics for each sector, the following general guiding rules were used in estimating the impact within the 26 census tracts identified. Additional census tracts that were within 6 miles driving distance were eliminated primarily due to their close proximity to an alternative source, e.g., Wal-Mart in Mesa on Broadway.

Guiding Rules (all adjusted if nearby competitors)

Home Improvement Sector:
Los Arcos attracts 60 percent of the market within 3 miles driving
Los Arcos attracts 30 percent of the market within 5-6 miles driving

General (Discount) Retail Sector:
Los Arcos attracts 40% of the market within 2 miles driving
Los Arcos attracts 20-30% of the market within 3-4 miles driving
Los Arcos attracts 10% of the market within 5-6 miles driving

Grocery Sector:
Assume all current shopping done within3 mile drive of residence.
Los Arcos attracts 25% of the market within 3 miles driving.
Los Arcos attracts 10% of the market within 5-6 miles-driving

These guiding rules are not perfect, but are consistent with general reach and distribution of stores in each sector. We also wanted to make reasonable to generous estimates of the success of the Los Arcos project, especially its pull from beyond Scottsdale's boundaries, since that is the objective the city is hoping to attain in the project.

Within specific census tracts, we then obtained estimates for what portion of $1 in spending in each sector would go to Los Arcos and what portion of that was redistributed from existing merchants in Scottsdale. The remainder would come from existing merchants outside Scottsdale. Because of the border along the Salt River Pima Maricopa Indian Community some of the sales come from there. Wal-Mart has a store at Pima and Chaparral and the large Scottsdale Pavilions off Indian Bend includes a Target and Home Depot. These centers are both outside Scottsdale as well as outside Phoenix, Tempe and Mesa. In reading the table the "% from Scottsdale" indicates the portion of expected sales at Los Arcos that are estimated to be currently done in Scottsdale, while the "% from Phoenix, Tempe, Mesa" refects the portion of expected sales at Los Arcos that are currently done in these localities. Table 1

Table 1

Sample Census Tacts

	Boundaries				Demographics		
Census Tract	N	S	W	E	Population	Portion of Rental Housing	Age 15-24
2179	Thomas	McDowell	Scottsdale	Hayden	3831	0.32	0.10
2171.01	Camelback	Indian School	Hayden	Granite Reef	2827	0.39	0.12
3189	University	Broadway	Beck	Ash	6753	0.52	0.23

	Spending at Los Arcos per $1 in Home Improvement Expenditure			Spending at Los Arcos per $1 in General Retail Expenditure			Spending at Los Arcos per $1 in Grocery Expenditure		
Census Tract	Amount	% From Scottsdale	% From Phoenix, Tempe, Mesa	Amount	% From Scottsdale	% From Phoenix, Tempe, Mesa	Amount	% From Scottsdale	% From Phoenix, Tempe, Mesa
2179	$0.60	50%	50%	$0.40	50%	50%	$.25	100%	0%
2171.01	$0.60	50%	0%	$0.10	0%	0%	$.10	100%	0%
3189	$0.30	0%	100%	$0.10	0%	100%	$.10	0%	100%

shows sample census tracts north of the project, bordering the project, and to the south of the project.

We then use the estimated sales from the city and developer combined with a categorical breakdown for each "big box" to determine the percent of sales tax revenues that are new to Scottsdale versus redistributed within Scottsdale. For purposes of calculation, we consider Lowe's as 100% Home Improvement, while Wal-Mart Supercenters are considered 70% general retail and 30% groceries, and Sam's Club is considered 50% General Retail and 50% Grocery. [7] We ignore the small shops, gas pad, and restaurants for two reasons. First, they are a very small portion of the sales for the project, approx. 6%. Second, Scottsdale is unlikely to capture significantly new revenues here. Los Arcos is not a large employment center, so lunch time traffic will mostly come from existing merchants in Scottsdale. Dinner will primarily serve existing neighborhood residents who would have eaten out elsewhere. Likewise, the gas pad will take much of its business from existing gas stations in Scottsdale.

Results:

We project that 60% of all sales at the Los Arcos Town Center will be sales that do not presently occur in Scottsdale, so based on our reasonable to generous assumptions, the Los Arcos Town Center will succeed in its aim of being a regional center drawing tax dollars to Scottsdale. These results are shown by sector and for the weighted average of these sectors in Table 2.

Table 2

New Revenues Generated by Los Arcos Town Center				
	Home Improvement	General Retail	Grocery	**ALL SALES**
Projection	66%	70%	39%	**60%**

However, the extent of subsidies completely negate any gain for Scottsdale. When examined more broadly we find that collectively, Scottsdale, Phoenix, Tempe, and Mesa will lose nearly $1 million annually in sales tax revenues. See Table 3.

Essentially if approximately 60% of the sales tax revenues are new, but you give away half of all sales tax revenues, then you only recoup 10% of sales tax revenues. For Scottsdale this means they received about 20% of new sales tax revenues with the Developer (and tenants) receiving 80% of such revenues. The net amount to Scottsdale is a scant $300,000 per year.

Another inappropriate comparison in previous economic impact studies has been to compare property tax revenues on the site now (vacant) with it being redeveloped. The site will be redeveloped; the question is how. Under the worse case scenario, if Ellman were to refuse to redevelop the site, the city could use powers of eminent domain to acquire and lease or re-sell it. For this reason property tax comparisons are excluded from the analysis with one exception, the parking garage which the Developer will construct and give to the city and then lease back through a parking management agency for $1 a year.

Table 3

Actual versus New Sales Tax Revenues

			By City		By Developer		By Pollack
Estimated Year 1 Sales							
	Wal-Mart	$	88,400,000	$	104,800,000	$	86,492,600
	Sam's Club	$	52,400,000	$	65,300,000	$	66,353,084
	Lowe's	$	49,200,000	$	45,000,000	$	37,680,160
	Total	$	190,000,000	$	215,100,000	$	190,525,844
Sales Tax (.014)		$	2,660,000	$	3,011,400	$	2,667,362
Share to Developer (.49)		$	1,303,400	$	1,475,586	$	1,307,007
Scottsdale Projected Increased Sales and Sales Tax Revenues							
From	Wal-Mart	$	53,633,137	$	63,583,176	$	52,475,899
	Sam's Club	$	28,560,645	$	35,591,797	$	36,165,781
	Lowe's	$	32,295,279	$	29,538,365	$	24,733,563
	Total	$	114,489,062	$	128,713,338	$	113,375,242
Net Sales Tax (.014)		$	1,602,847	$	1,801,987	$	1,587,253
Share to Developer		$	1,303,400	$	1,475,586	$	1,307,007
% of Tax to Developer			81%		82%		82%
Share to Scottsdale		$	299,447	$	326,401	$	280,246
% of Tax to Scottsdale			19%		18%		18%
Parking Garage Lease Adjustment*		$	(362,853)	$	(362,853)	$	(362,853)
Net Subsidy to Developer		$	1,666,253	$	1,838,439	$	1,669,860
Net to Scottsdale		$	(63,406)	$	(36,452)	$	(82,607)
Net Sales Taxes to Local Government (all localities included)							
Sales Tax (Loss) to Phoenix, Tempe & Mesa		$	(1,415,357)	$	(1,595,960)	$	(1,410,515)
					(average sales tax rate .0167)		
Net Sales Tax (Loss) to Local Governments (Scottsdale, Phoenix, Tempe, & Mesa)		$	(887,080)	$	(1,011,530)	$	(902,221)
			(for consistency sales tax equalized to .014 across localities)				

*Actually the first 8 years of the parking garage tax are abated (not paid), so the actual subsidy is larger than stated here. The amount is included here to illustrate that even without the abatement Scottsdale loses money.

A parking garage is a clear benefit to the site as it reduces the acreage needed for parking, enabling a greater share of acreage to be devoted to retail space. This enables the overall site to be used more efficiently. But parking garages are more expensive to build than asphalt parking lots. However, the Developer also reaps a great benefit as the parking garage condenses parking and enables added retail space, so the project is more lucrative. Any city incentive just needs to be enough to tip the scale so that the project is more lucrative with a parking garage than without one.

In this case, while we don't have sufficient data to determine what the minimum necessary incentive would be, it appears the city may have tipped the scale over rather than just tip the scale with incentives.[8] The city has chosen to subsidize the parking garage in two ways. Through the lease back arrangement, the developer owes far less taxes, but then those taxes are also abated for the first 8 years. As a result after 8 years the Developer will pay Government Property Lease Excise Taxes (GPLET) on the parking garage and its 20 acres. Currently this tax amounts to $100 per parking space and would generate $210,000 in revenues. By contrast if the Developer owed a property tax on a parking garage with a land and improvement market value of $23 million, the city would receive more than twice that amount or $572,853. These results are shown in Table 4.

Table 4

Parking Garage Lease Back Tax Subsidy

Property Taxes			Lease Excise Tax		
Land Value Per City	$	11,750,000	Parking Spaces in Structure		2,100
Improvement Value Per City	$	11,510,000			
Total Value	$	23,260,000	Tax Rate Per Space	$	100
Commercial Assessment Ratio		x 25%	**Annual GPLET**	**$**	**210,000**
Assessed Value	$	5,815,000			
Divide by $100	$	58,150			
Tax Rate Per $100	$	9.85			
Annual Property Taxes	**$**	**572,853**			

Looking at the complete subsidy package, the total subsidy the Developer receives in the first year is understated in the Table 3 which made a $363,000 adjustment for this lease back provision. Since the Developer actually saves $573,000 in property taxes, the correct first year subsidy is nearly $2 million (adding the sales tax share to the developer to $572, 853). Likewise, Table 3 underestimates Scottsdale's actual loss in the first year. Scottsdale's actual loss in the first year is nearly $300,000 (taking Scottsdale's share of new sales tax revenues from the Table 3, approximately $300,000, and subtracting $572,853).

However, because the lease back arrangement is set for 40 years, we have chosen to focus only on the permanent portion of the subsidy, the difference between the property tax liability and GPLET. The comparison of the two tax set ups are shown above in Table 4.

We have not attempted to estimate results over a 40-year horizon, because it's unlikely this facility will survive for more than 20 years without significant new investment/redevelopment. We can forecast that in the shorter-term revenue losses for the City of Scottsdale will most likely worsen.

If the Los Arcos Town Center experiences a growth in revenues due to the closure of K-Mart and/or a local supermarket, Scottsdale will lose additional revenues. While our year one estimate includes a draw on business away from K-Mart, we did not assume that K-Mart closes. If K-Mart closed, then Scottsdale would lose all of K-Mart's tax revenue. For purposes of argument let's assume the K-Mart is 80,000 square feet and has sales of $200 per square foot due to the proximity of Wal-Mart during year one, much lower than their chain average of current sales of $242 per sq. foot.[9] If in year two K-Mart closes and those sales are captured entirely by Wal-Mart, then Scottsdale would lose an additional $110,000 in sales tax revenues annually (see Table 5).

Table 5

Tax Impact if K-Mart Sales Transferred to Wal-Mart

	Sales	Sales Tax
K-Mart (100%)	$ 16,000,000	$ 224,000
Wal-Mart (51%)	$ 16,000,000	$ 114,240
Change in Scottsdale Sales Tax Revenue		$ (109,760)

Conclusion:

As proposed the development agreement between Ellman Companies is a bad deal for Scottsdale taxpayers and bordering local governments. Using reasonable to generous assumptions we find 60% of the sales revenues will be new revenues for Scottsdale. But Scottsdale gives away 80% of these new sales tax revenues to the Developer, leaving only 20%. However, due to the parking garage lease back arrangement, the Developer receives an additional subsidy of approximately $350,000 per year. Because this additional subsidy exceeds the 20% in new sales tax revenues, Scottsdale taxpayers lose money on the deal, while the Developer and its major tenants will receive $1.8 million in public subsidies annually.

Due to the impact of the Los Arcos Town Center on existing businesses, we expect that one or more anchors in neighboring retail centers will close. With these possible closures, much of that business will be captured by Los Arcos Town Center, resulting in additional tax loses as the city will receive only 51% of sales tax revenues where it formerly received 100% of such revenues.

Collectively the local governments of Scottsdale, Tempe, Phoenix, and Mesa will lose $1 million annually in sales tax revenues.

We must acknowledge that to make these estimates we rely on a number of simplifying assumptions, but the bottom line is what percent of sales tax revenues come from existing Scottsdale merchants and what portion comes from merchants outside Scottsdale. To the degree we have been too generous in our assumptions, meaning less than 60% of the sales revenues from Los Arcos Town Center come from merchants located outside Scottsdale, then the losses for Scottsdale taxpayers will be worse. This will mean more of Los Arcos Town Center's revenues will be redistributed from existing merchants in Scottsdale. The City willl receive less than 20% of the new sales tax money, and the Developer will receive more than 80% of new sales tax money.

By contrast, if Los Arcos pulls more than 60% of its sales from merchants outside Scottsdale, then Scottsdale's picture will be better, but the losses to Tempe, Phoenix and Mesa will be worse.

However, even under a slightly improved scenario, Scottsdale would make only modest tax revenue gains relative to what could be gained, as it's doubtful the proposed development needs a subsidy to be profitable.

In addition, the city will have aligned itself with Wal-Mart, a corporation currently being targeted for gender discrimination and frequently cited for failing to adequately compensate its workforce. If the city wishes to subsidize major retail outlets, Wal-Mart's practices do not seem to be consistent with the ethical values of the city.

Overall, based on economic and ethical grounds the working families of Scottsdale are poorly served by this proposal as currently constructed.

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Endnotes:

[1] City of Scottsdale Economic Vitality Office (2003), "Economic Development Incentives: A White Paper Developed for the Scottsdale City Council," February, p. 11.
[2] Mattern, Hal (2003), "Wal-Mart Bringing Grocery (And A Battle) To Arizona," *Arizona Republic*, February 21, p. A1.
[3] A recent study found women were paid 4.5% to 5.6% less than men doing similar jobs with comparable levels of experience. The class action suit could include more than 1million current and former employees, making it the largest in U.S. History. Source: Giron, Lisa (2003), "Study Finds Pay Gap at Wal-Mart: Analysis Conducted as Part of a Lawsuit Says Women Earned Less Than Men in All Pay Ranks," *Los Angeles Times*, February 4.
[4] Callahan, Patricia and Ann Zimmerman (2003), "Price War in Aisle 3 --- Wal-Mart Tops Grocery List With Supercenter Format; But Fewer Choices, Amenities," *Wall Street Journal*, May 27, p. B1.
[5] Cook, Rebecca (2003), "Businesses Misuse State Health Plan, Some Say," *Seattle Times*, February 28.
[6] Wright, Lesley and Kristen Go (2003), "Backers in Council Set to OK Mall Deal: Foe of Los Arcos Calls Deal 'Insane,'" *Arizona Republic*, June 25.
[7] Creno, Glen (2002), "The March of Wal-Mart Retail Giant is Expanding in Arizona," *Arizona Republic*, January 20, p. D1.
[8] The proper way to weigh necessary incentives is to compare the profitability of the project with less retail square feet and no parking garage with the profitability of the project with more retail square feet and a parking garage.
[9] "The March of Wal-Mart Retail Giant is Expanding in Arizona."