



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: May 27, 2014 REPORT NO: 14-051
ATTENTION: City Council
SUBJECT: Economic Development Agreement – Alesmith Brewing Co.
REFERENCE: Council Policy 900-12 “Business & Industry Incentive Program”

REQUESTED ACTION: Forward the Economic Development Agreement to the City Council for approval

STAFF RECOMMENDATION: Forward the Economic Development Agreement to the City Council for approval

SUMMARY:

Background

As explained in the draft Economic Development Strategy 2014-2016, San Diego’s economic base is principally comprised of four economic engines or base sectors which generate wealth for the City and the surrounding metropolitan area by exporting goods and services, or by reducing imports through local production. These economic base sectors are the military, tourism, manufacturing, and international trade. Manufacturing is the largest of these base sectors when measured in terms of its overall contribution to Gross Regional Product (GRP) at \$15.1 billion, and is the second only to Tourism in terms of employment at 122,000. San Diego’s manufacturing sector is dominated by high-technology industries such as aerospace, ship-building, biotechnology, electronics, telecommunications. Food and beverage producers have always had a small but significant role in the local economy beginning with the tuna canning industry in the early 1900’s. More recently, the beer manufacturing industry has seen explosive growth due to the growing consumer preference for “craft beer” produced in microbreweries.

Although San Diego’s beer manufacturing industry dates back to the defunct Aztec Brewery of Barrio Logan and Mission Brewery in the Midway community, the City’s modern microbreweries began with the establishment of the Karl Strauss brew-pub on Columbia Street in downtown in 1989. In 1995 three important events set the stage for the future growth of the industry. Alesmith Brewing Company opened a small brewery in the Miramar industrial area, Ballast Point Brewing Co. opened Home Brew Mart, a retail home brewing equipment and supply store with a small on-site brewery in a commercial area of Linda Vista, and White Labs, a manufacturer of brewers and vintners yeast opened a small production plant in the Miramar

industrial area. Over the course of the next 19 years, Alesmith went on to win more Gold, Silver and Bronze medals in international beer competitions than any other San Diego brewing company, Ballast Point became the City's largest beer manufacturing company, and White Labs has become the nation's pre-eminent yeast supplier to the industry.

In the mean time, San Diego's home brewers and commercial-scale brewers had gradually built up internal collaborative support networks, buying and selling equipment to each other, sharing production techniques and building brand loyalty among an ever-larger customer base. Escondido-based Stone Brewing built a distributorship which helped local brewers to penetrate markets which had been exclusively dominated by the major manufacturers such as Anheuser-Busch, Miller, and Coors, as well as more established "craft" brewers such as Sierra Nevada, Boston, and Widmer Brothers.

San Diego now has 19 brewpubs and 22 breweries, with three more breweries currently under construction, more than any other city in California. Several of these are significant industrial-scale breweries with bottling and canning capabilities making it possible to sell beer at wholesale in dozens of states and foreign countries.

The manufacturing of beer creates middle-wage job opportunities which do not require college degrees, meaning that jobs created in this industry are likely to be made available to local residents rather than imported labor. Beer manufacturing has a job multiplier factor of 5.7:1, one of the highest of all industries. Thus each direct job creates 4.7 additional jobs in the service sectors, such as wholesale, retail, the trades, finance, insurance, real estate, etc. Additionally, beer manufacturers in California are able to sell product at retail in breweries, brewpubs, and tasting stores, thus generating sales tax revenue for local jurisdictions. San Diego's brewers produce extremely high quality beers in a great many styles, which also substantially contributes to the Tourism Sector much like vintners do in northern California counties such as Napa and Sonoma. This attraction of visitors increases the sale of room nights at hotels, which in turn creates more jobs and additional sources of tax revenue. A recent study prepared by the National University System Institute for Policy Research (NUSIPR) concluded that the San Diego County "craft beer" industry as a whole generates a \$300 million annual economic impact to the region. For all of these reasons, beer manufacturers are highly sought after by cities throughout the United States.

By 2012 AleSmith had completely maxed out the capacity of its 10,000 square foot production brewery in Mira Mesa. The company began a search for a factory building in the 70-100,000 square foot range, large enough to greatly increase production capacity but also large enough to provide for a 10-15,000 square foot full service restaurant, tasting room, creamery, plus office space to increase its sales force. In 2013, AleSmith retained Urban Contracting as its site-selection and project consultant to locate a vacant industrial building or undeveloped industrial land parcel. While Alesmith indicated to the City that it preferred to remain in the Miramar industrial area, other mid-county and North County cities were also being considered. During this time city staff brought forth and the City Council approved the "Microbrewery Ordinance" which amended the Municipal Code to allow beer manufacturers to build and operate large full service restaurants within breweries, as accessory uses.

By late summer of 2013, Ballast Point Brewing & Spirits had entered into a lease agreement to occupy the vacant Van Can factory on Carroll Way, potentially anchoring a growing cluster of breweries in Mira Mesa. This cluster was particularly concentrated in the Miramar area where AleSmith (existing brewery) had been joined by Green Flash, Saint Archer, Rough Draft, Hess, Two Kids, Galactic, Wet N Wreckless, and White Labs. Karl Strauss and San Diego Brewing Co. continued to operate brewpubs in Mira Mesa as well. Hoist Fitness closed its gym equipment manufacturing plant at 9990 Empire St. after relocating its manufacturing operations to the City of Poway, presenting both a problem and an opportunity for the City. The City had a strong interest in getting the vacant plant re-opened under new management as well as building upon the success of the Ballast Point retention and growing Miramar brewery cluster. A brewery in the 100,000+ square foot range would be among the ten largest in the entire State of California. If AleSmith followed Ballast Point's lead in selecting San Diego for its major expansion, San Diego would become the first City in California to have two of the state's top 10 largest breweries.

Discussion

Industry Concentration in Mira Mesa

The Sorrento Mesa and Miramar industrial areas have become an attractive location for microbreweries and brewpubs due to a number of factors. Factory and other business closures during the recession have resulted in downward pressure on lease rates and the availability of suitable industrial structures. The central location offers excellent customer access and visibility for retail sales, fairly reasonable lease rates, a more flexible regulatory environment, and the possibility of "beer tours" due to close proximity of existing and future breweries. It became clear to City staff that attracting more and larger breweries to this area could accelerate the growth of this industry and maximize the public benefits associated with the creation of new jobs and tax revenue.

The City's offer of assistance

On September 6, 2013 the City offered a package of financial incentives and non-monetary assistance to AleSmith. This "offer sheet" is shown on Attachment 1 to this report. The item of potentially greatest value is the offer to reimburse AleSmith's City fee costs using tax revenue to be paid by AleSmith and generated as a result of converting the vacant Hoist Fitness factory into a large-scale brewery and restaurant.

Council Policy 900-12 "The Business & Industry Incentive Program"

Council Policy 900-12 was enacted in 1993, towards the end of a national recession which was exacerbated locally due to the collapse of the Savings & Loan industry and massive defense cuts. This new program was based on several of the recommendations of the City's Economic Development Task Force of 1992. The policy provides for the provision of direct financial and other assistance to businesses which are both willing and able to provide extraordinary public benefits such as the creation of base sector jobs, tax revenues, or urban revitalization. In 2001, the City Council approved amendments to Council Policy 900-12 in connection with the simultaneous adoption of the Community & Economic Development Strategy 2002-2004.

Among other things, the amended Council Policy 900-12 affirmed and provided greater specificity for the approval of fee reimbursements for business projects.

This provision is found in section B(2)(a) of the current policy and reads:

“The City Council must approve any one or more of the following incentives:

Reimbursing all or a portion of City permit processing fees, Development Impact Fees, Facilities Benefit Assessments, Housing Impact Fees, Water/Sewer Capacity fees, fees collected pursuant to Developer Reimbursement Agreements, and/or costs of public improvements that are a required condition of the development, from future revenues to the City generated directly from the project after the City’s receipt thereof.”

This provision of Council Policy 900-12 has been utilized and implemented twice since 1993, first in 1998 for a proposed 6-building 230,000 R&D industrial complex built by Novartis, and again in 2001 for a corporate headquarters/R&D industrial complex built by IDEC Pharmaceuticals. Both projects are located in the University Community. Novartis received a full reimbursement of its Housing Impact Fees (HIF’s) totaling \$172,000. IDEC Pharmaceuticals was awarded a potential reimbursement of Housing Impact Fees totaling up to \$614,000, however the company defaulted on the terms of the Agreement and no reimbursement was ultimately provided. That industrial complex was abandoned by Biogen-IDEC Corp. in 2011 and is now leased by Illumina, Inc. another biotech company.

The proposed Economic Development Agreement with AleSmith Brewing Co.

The proposed Economic Development Agreement (EDA) with AleSmith would require the City to reimburse the Company for all City development-related fees associated with the retrofit and improvement of the former Hoist Fitness factory at 9990 Empire St. so long as such fees are incurred prior to December 31, 2015. AleSmith has not incurred any City fees thus far, but is expected to incur fees payable to the City approximately equal to those fee costs incurred by Ballast Point Brewing & Spirits Co. for a similar project. AleSmith is expected to incur fees of approximately \$150,600 broken out as follows:

Fee Type	Fund	Approx. Amount
Facilities Benefit Assessment	Mira Mesa PFFP Fund	\$70,000
Plan Check, Inspection, + other cost-recovery fees	DSD Enterprise Fund	\$80,000
Total City Fee Costs		\$150,000

The City expects to receive tax revenues from AleSmith in connection with this project from the following sources, and the proposed EDA would require the City to reimburse AleSmith’s fee costs using future tax revenues as the funding sources, based on the Reimbursement Credit Formula’s specified in the proposed Agreement:

Taxation	Activity/Source	Reimbursement Credit Formula
Property Tax (secured real property)	Increased assessed valuation of real property based upon improvements	100%
Property Tax (unsecured personal property)	Purchase and use of taxable fixtures, furnishings, and equipment (FF&E)	100%
Use Tax	Purchase and use of taxable fixtures, furnishings, and equipment (FF&E)	100%
Sales Tax	Retail sales of beer, prepared food, and other merchandise to consumers from outside the City of San Diego (estimated at 50% of total sales)	50%

The brewery is expected to commence production towards the middle of FY2015 (March of 2015), but tax revenues will likely not be received by the City until towards the end of FY2015. These revenues will mostly result from use tax on equipment placed into service during early-mid FY2015. Completion of the restaurant will most likely be deferred to a 2nd or even 3rd phase of construction in the early part of calendar year 2016 such that the bulk of the revenue and subsequent reimbursement activity will most likely occur in FY2016 or FY2017 when the entire facility is fully operational. Sufficient Business Cooperation Program (BCP) funds are budgeted for FY2015 in the Citywide account, however it may be necessary to budget an additional \$50-100,000 for FY2016 to fund additional reimbursements in that fiscal year. Assuming average net tax revenue generation of \$50,000 annually, the City expects to complete its obligations under the terms of the EDA within four calendar years, after which the City will begin receiving net gains of this amount or more annually thereafter.

Brewery Project and Projected Public Benefits

Based in part on incentives offered to AleSmith, the company has leased the Hoist Fitness factory and expects to begin the retrofit in August of this year. The brewery will ultimately have the capacity to produce 150,000-200,000 barrels annually and will include an approximately 4,000 square foot full service restaurant, an outdoor patio, a two tasting rooms, and a gift shop. The project is projected to create at least 25 additional new jobs initially (+25 retained jobs) and at least \$50,000 annually in tax revenue to the City less the amount of fee reimbursements paid to AleSmith. At 105,636 square feet, the AleSmith brewery will be the third largest brewery (in size) in San Diego County and 8th largest in California.

EQUAL OPPORTUNITY CONTRACTING INFORMATION:

This action is not subject to the City's Equal Opportunity Contracting (San Diego Ordinance No. 18173, Section 22.2701 through 22.2708) and Non-Discrimination in Contracting Ordinance (San Diego Municipal Code Sections 22.3501 through 22.3517).

FISCAL CONSIDERATIONS:

Fiscal impacts of the proposed Council Action are entirely revenue positive. In order to obtain the investment, the City would forego any net tax revenue gains until all of AleSmith's City fee

costs are reimbursed. This is expected to take approximately four years. After that time, the City expects to receive approximately \$50,000 annually in net new tax revenues which would likely not be received unless the Hoist Fitness factory was re-used by a business generating an equal or greater amount of tax revenue. The City has been receiving only approximately \$18,000 annually in property tax revenue and no sales or use tax revenue since the plant closure.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

The proposed Economic Development Agreement was not executed in time to be considered by the Economic Development & Intergovernmental Relations Committee on April 9, 2014 as an action item. So, it was reviewed in concept by that Committee and forwarded for City Council consideration without recommendation. At that time, the ED&IR Committee did review a nearly identical EDA for Ballast Point Brewing & Spirits Co. for a very similar project in the same Miramar industrial area. ED&IR recommended approval of the proposed EDA with Ballast Point by a vote of 3-0.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

Not applicable – Confidential municipality-taxpayer negotiations

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Not applicable



Bill Fulton
Director
Planning, Neighborhoods & Economic Dev.



Ronald H. Villa
Deputy Chief Operating Officer

- Attachments(s):
1. Offer Sheet to AleSmith Brewing Co.
 2. Proposed Economic Development Agreement
 3. California's Largest Breweries
 4. Project Site Information