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Title: Adopt the resolution approving the sales tax revenue sharing agreement between the City of Naperville and Costco Wholesale Corporation

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Attachments: 1. 2018 City Council Letter to NDP, 2. Resolution Approving Sales Tax Revenue Sharing Agreement, 3. Sales Tax Revenue Sharing Agreement

Date	Ver.	Action By	Action	Result
2/18/2020	1	City Council	passed	Pass

CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:

Adopt the resolution approving the sales tax revenue sharing agreement between the City of Naperville and Costco Wholesale Corporation

DEPARTMENT: Transportation, Engineering and Development

SUBMITTED BY: William J. Novack, Director of TED/City Engineer

BOARD/COMMISSION REVIEW:

NA

BACKGROUND:

In 2015, the Naperville City Council approved four ends policies to help guide the City's priorities in the coming years. Our **Economic Development** ends policy states:

“Naperville will be the location of choice for businesses”

The City also established goals under each of our Ends Policy categories including the following goal:

“In order to improve the vibrancy and increase retail sales tax, the City will actively seek to fill vacant spaces at Ogden Mall, Iroquois Mall and the northwest corner of Ogden Avenue and Naper Boulevard.”

The east Ogden corridor is a vital commercial area for the City of Naperville with over 35,000 vehicles traveling through the corridor daily. Since the closure of Kmart in April of 2013, the Ogden Mall has struggled with its occupancy level. The City recognized the need to focus economic

development efforts on east Ogden Avenue to maintain its role as a vital business and service corridor and asset to the City. Filling critical commercial vacancies in this area has many benefits:

- Residents will have increased shopping opportunities and shorter travel times to a retail destination
- The appearance of the east Ogden Corridor will be improved
- The City's sales and property tax bases will be increased
- There will be increased interest in the corridor, which will spur occupancy of other, smaller nearby tenant spaces and improve business for all property owners

While all City goals are important, the goal related to filling vacant spaces on Ogden Avenue took special prominence amongst the City's goals. This is evidenced by the attached May 2018 letter to from the City Council to the Naperville Development Partnership (NDP) highlighting its priority.

Since 2015, NDP, City Council and City staff have worked diligently on economic development efforts in the Ogden corridor including hosting property owner meetings, initiating a pole sign replacement grant program, coordinating with Com Ed for the burial of overhead lines, and meeting with potential tenants.

In 2018, the City and NDP held an east Ogden open house to get input from business operators, property owners and nearby residents. At that time, the City contemplated physical improvements along the corridor, such as ornamental street lights, improved street signs, and landscaping to attract tenants to the area. While most attendees liked the potential improvements, their highest priority in the corridor was to fill the old Kmart vacancy at the Ogden Mall. Given the feedback, the City and NDP continued focusing on attracting businesses for the east Ogden Avenue and especially the Kmart site.

The owner of the Ogden Mall has been open to NDP's help in attracting a new anchor tenant for the property. Recently, the Mall was explored as a potential site for the DuPage Children's Museum relocation. After those discussions ended, NDP started to discuss the location with Costco.

DISCUSSION:

Costco Wholesale Corporation (Costco) operates many stores in the region, including one in Naperville located at 75th Street and IL Route 59. The Naperville store has always performed very well and following the closure of Sam's Club the demand on the 75th Street Costco has increased beyond the company's preferred threshold. Costco reports that when demand is too high in a single location, some customers choose to visit the store less frequently due to crowding or visit other stores in other communities.

Because of its membership database Costco, can identify the optimal areas to locate additional stores. Costco has been exploring locating a store in Lisle, Warrenville or around northeastern Naperville for over five years. In October, Costco entered into a contract to purchase the western 18.5 acres of the Ogden Mall. Its plan is to demolish the existing buildings and parking lot (not including H-Mart) and construct a new Costco store and fueling station. Costco is prepared to take possession of the property this late summer, start construction in the fall, and open the store in the fourth quarter of 2021, or earlier.

For Costco to commit to building and opening a new store, it must demonstrate that it will meet corporate profit thresholds within the first six years of operation. Those returns are driven by

demographic densities, store sales and the cost to acquire the land and construct the facilities. In some situations, Costco cannot meet the requirements without municipal financial assistance. This needed assistance almost always takes the form of a sales tax revenue sharing agreement with the local municipality.

Costco has informed the City that it requires a minimum \$5.5 million in sales tax rebate incentive to profitably build and operate a store at the Ogden Mall. Without the incentive, Costco will not proceed with a store at this location. It is a simple and strict business decision that Costco uses when assessing all new locations, and one of the things that has made Costco such a successful business.

Some of the challenges that drive Costco's need for the revenue sharing at this site include:

1. The high total cost to acquire this site and construct this store. This will likely be among Costco's most expensive units in the Midwest.
2. This site will draw customers from five existing Costco stores in the area, including from the existing Naperville store; so many of the new store's customers will be current, not new, Costco customers. The other Costco units will be cannibalized to varying degrees.
3. The large forest preserve property north of Warrenville Road presents a potential barrier to drawing customers from the north of it, thus limiting this potential new store's customer base, resulting sales and Costco's return on investment.

The City of Naperville has been strategic in its limited use of economic development incentives, setting a goal and using incentives to achieve that goal. When the City prioritized the development of a luxury full-service hotel, an incentive was approved with Hotel Arista. When the City established the need for a hotel with a banquet facility that could seat 1,000 people, an incentive was approved to develop the Embassy Suites. When the City aimed to upgrade the flag and renovate a large, prominently located hotel, the incentive to develop the Marriott was approved. With the stated goal of improving vibrancy, increasing retail sales tax, and actively seeking to fill vacant spaces at Ogden Mall, the proposed incentive with Costco for this identified strategic location fits the criteria for a financial incentive.

The proposed agreement provides Costco with a rebate of 75% of both the City's portion of the state sales tax and the City's local home-rule sales tax from the new store. Notably, the City's local motor fuel tax that will be generated from the new store's fueling station is **not** included as part of the rebate agreement. The 75% split allows the incentive to be fulfilled as quickly as possible without resulting in any overall reduction in the City's sales tax income. Staff, working with Costco, estimates that the existing Naperville Costco store on 75th Street will experience an initial 11% reduction in sales due to the opening of the proposed new store at the Ogden Mall decreasing over time. The proposed agreement is structured so that the City will receive enough sales tax revenues from the new store to offset any reduction of revenues from the existing store. Consistent with all other incentive agreements, the City will not forgo any existing revenues.

While Costco's precise store revenue performance and forecasts are proprietary, City staff has estimated the following projections of potential sales tax revenues based on analysis of the current Naperville unit and discussions with Costco.

The total sales tax column includes both the City's portion of the state's sales tax and the City's home

-rule sales tax. The motor fuel tax column includes consideration of other possible reductions from other Naperville fueling stations due to customers switching to the Costco station. The amount shown as "City's Share" is the net additional revenues to the City from the new Costco store over the period shown.

Year	New Store Total Sales Tax	New Store Motor Fuel Tax	Costco's Share (75% of Sales Tax)	City's Share (25% + MFT)
Year 1	\$1,250,000	\$270,000	\$938,000	\$582,000
Year 2	\$1,363,000	\$294,000	\$1,022,000	\$635,000
Year 3	\$1,485,000	\$321,000	\$1,114,000	\$692,000
Year 4	\$1,604,000	\$346,000	\$1,203,000	\$747,000
Year 5	\$1,732,000	\$374,000	\$1,223,000	\$883,000
Total	\$7,434,000	\$1,605,000	\$5,500,000	\$3,539,000

If the projections above are accurate, then Costco's incentive may be fully rebated within the first five years of Costco's store opening. Costco's conservative expectation based on its own estimates is that the incentive should be fully rebated within five to eight years of its store opening. The term of the agreement is 15 years or until Costco receives the full rebate, whichever occurs first.

In conclusion, this revenue sharing agreement is beneficial for the long-term financial health of the City and its residents and businesses, particularly along the east Ogden corridor. The agreement is structured such that the City is protected from experiencing any reduction in sales tax revenue during the period that Costco's sales tax revenues are being shared. After the rebate is satisfied the City will see a significant (over \$1 million) increase in sales tax receipts for the foreseeable future while Costco remains in operation.

FISCAL IMPACT:

While \$5.5 million in the City's sales taxes will be rebated to Costco, the City does not expect to experience a net reduction in sales tax revenue received from Costco between its two local stores. The City will receive all the local motor fuel tax from Costco's new gas station which is estimated to be between \$270,000 and \$400,000 annually. After the incentive agreement is fulfilled, the City anticipates it will continue to receive over \$1 million annually in sales tax from this new Costco store.