



PINNACLE PETROLEUM, INC.
AB 562 – ECONOMIC DEVELOPMENT STRATEGY
JOB RETENTION

THE CITY OF HUNTINGTON BEACH



April 14, 2014

Ms. Kellee Fritzal
Deputy Director Business Development
CITY OF HUNTINGTON BEACH
2000 Main Street
Huntington Beach, CA 92648

RE: Pinnacle Petroleum, Inc.
AB 562 - Economic Development Strategy
Job Retention

Dear Ms. Fritzal:

The City of Huntington Beach (City) has commissioned Tierra West Advisors, Inc. (Tierra West) to review, analyze and prepare a report pertaining to a Operating Covenant Agreement (Agreement), between the City and Pinnacle Petroleum, Inc. (Pinnacle) based upon the economic development strategy and to comply with the newly enacted public reporting requirements of Assembly Bill 562 (AB 562).

The State Legislature and Governor Brown, due to the elimination of Redevelopment addressed the loud outcry by cities, counties and communities for the need to legislatively assist local agencies, as well as the State, to encourage employment, retain jobs and companies in local communities. The loss of redevelopment has left the City of Huntington Beach with a loss of local resources to encourage economic development. In response to this loss, the City of Huntington Beach is developing an economic development strategy and is also considering an economic development subsidy that will comply with the continued public reporting provisions mandated by AB 562.

Pinnacle, located in Huntington Beach, is proposing to maintain its headquarters within the City for the next 15 years. In order to remain competitive and promote expansion, Pinnacle and the City are proposing to enter into the Agreement and revenue sharing arrangement as part of the City's Economic Development Program. The Agreement is intended to provide Pinnacle and the City the ability to address among others:

- Decline in competitiveness due to industry consolidation
- Update existing Tax Sharing Agreement terms
- Extend Pinnacle's operations in the City
- Retain City General Fund revenues to provide needed services for residents
- Retain and capture future growth in Pinnacle product sales (leveraging on estimated future revenue and industry price increases)

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REAL ESTATE & DEVELOPMENT
STRATEGISTS

- Increase the economic competitiveness of Huntington Beach
- Increase the City's wealth and prosperity
- Diversify the City's economic base and wage levels
- Outreach and support to existing businesses
- Maintain and enhancing a consistent, business-friendly environment
- Expand public-private partnership opportunities

Tierra West recognizes that the provisions of the Operating Covenant Agreement and retention of Pinnacle would not only assist Pinnacle but also provide a strong public purpose through the City's continued expansion of economic development opportunities for businesses within the City and continued growth of the City's General Fund revenue and tax base, as well as improve economic and physical conditions and services in the City.

Sincerely,
TIERRA WEST ADVISORS, INC.



John N. Yonai

**City of Huntington Beach
Economic Development (AB562)
Operating Covenant Agreement
between
City of Huntington Beach
and
Pinnacle Petroleum, Inc.**

The City of Huntington Beach (City) in order to maintain sustainable economic development, community vitality and recovery from the annual loss of over \$21 million previously received by the City's Redevelopment Agency, is implementing economic development strategies that include the application of Assembly Bill (AB) 562. The City and Pinnacle Petroleum, Inc. (Pinnacle) propose to enter into an Operating Covenant Agreement (Agreement). The Agreement requires Pinnacle to remain in operation in the City and the City will continue to provide revenue sharing with Pinnacle.

The loss of redevelopment has left the City of Huntington Beach as well as all cities Statewide with a loss of local resources to encourage economic development and maintain local services. The California Legislature and Governor Brown made the decision to terminate redevelopment and removed the single largest economic tool available to local agencies. Based upon the decision to terminate redevelopment Statewide, the Governor and Legislature recognized the necessity of cities, counties and the State, to encourage employment and retain jobs and companies by giving economic subsidies to businesses and the importance of providing public input by requiring:

1. A public hearing prior to the granting of the subsidy
2. A report regarding the subsidy within the term
3. Where a subsidy has a term of more than 10 years, an additional public hearing at the conclusion of the subsidy.

The State approved AB 562, which went into effect on January 1, 2014, codifying a continued public reporting requirement for economic development subsidies.

This report includes the information required by AB 562 and the fiscal analysis necessary to determine the projected revenue generated by Pinnacle to the City as part of the economic development strategy for business retention through an Operating Covenant Agreement. The City-provided information which was utilized to establish an estimated "Revenue Tax Base" of sales tax collected by the City from Pinnacle. After the Revenue Tax Base was determined, projections of additional revenue generation from sales tax collections directly attributable to the business were developed. The projected revenue tax increases from Pinnacle represents new resources as well as the retention of a portion of existing general fund revenues to the City of which a percentage of the revenue collected will be shared with Pinnacle. This will avoid significant fiscal Impacts to City revenues and community services.

The economic development strategies seek demonstration that the proposed business retention will result in community-wide benefits, which is evidenced by the retention of revenues that will be used to provide municipal services. The City Council may choose to approve the Agreement in order to retain and expand jobs, maintain a local business, assist Pinnacle to gain competitiveness within the fuel provision industry and incentivize the business owner to consider and complete upgrades and improvements. This report identifies the financial data necessary to allow the City Council to determine the value of entering into the proposed Agreement.

AB 562 Reporting Requirements

On and after January 1, 2014, each local agency shall, before approving any economic development subsidy within its jurisdiction, provide all of the following information in written form available to the public, and through its Internet Web site, if applicable:

1. The name and address of all corporations or any other business entities, except for sole proprietorships, that are the beneficiary of the economic development subsidy, if applicable.

Pinnacle Petroleum, Inc., 7911 Professional Circle, Huntington Beach, CA 92648

Founded in 1995, Pinnacle Petroleum, Inc. (Pinnacle) is a national provider of competitively priced energy products and services. Pinnacle services include the distribution of refined petroleum products and lubricants, environmental services, cardlock fueling, and remote tank monitoring with a fully integrated fuel management system. Pinnacle is a 100% woman owned California Corporation. Certifications include WBENC #240301 with WMBE Clearinghouse #95IS0030.

Refined Petroleum Industry

The refined petroleum products market in the US grew 22 percent between 2006-2012 despite a sharp decline in consumption and price during the economic downturn. The local refined petroleum products industry followed similar trends, growing by an average of 6 percent per year during the 2006-2012 review period. The US refined petroleum products industry became more export oriented with the share of exports increasing from 6 percent in 2006 to 16 percent in 2012. Strong growth is forecast for the industry as high prices and recovering volume demand will propel revenues.

2. The start and end dates and schedule, if applicable, for the economic development subsidy.

Operating Covenant Agreement, if approved is anticipated to commence on July 1, 2014 and continue for ten (10) years with one (1) five (5) year option term by mutual agreement.

Sales Tax Generation

The Bradley Burns Uniform Local Sales and Use Tax (“Bradley Burns”) applies to the sales of tangible personal property in which a percentage of California’s sales and use tax rate is distributed back to the jurisdiction where sales were generated to support local general funds. For many jurisdictions, including the City, this amount is one percent (1%). Sales tax is payable to the City from the State Board of Equalization. The calculations in this report indicate only the estimated amount of sales tax to be received

by the City through the distribution formula used by the State Board of Equalization. Pinnacle proposes to maintain and enhance existing business operations in the City. The City and Pinnacle mutually agreed that a Sales Tax Base would be set at \$25,000 per quarter to offset and minimize any potential decline in current general fund revenue. Therefore, the City would receive the first \$25,000 each quarter and revenue sharing would commence on any sales tax generated by Pinnacle above this amount.

Sales projections were developed based upon review of retail sales data between the years of 2008 through 2013. According to the historical sales data, Pinnacle generated on average approximately \$243,000 in revenue per quarter or approximately \$972,000 annually. 2012 and 2013 data indicated steady growth in revenue with an average of \$254,000 in sales per quarter or \$1.016 million per year.

The City and Pinnacle are presently under contract with a Sales Tax Agreement entered in July 2007 and includes the following terms: The City provides Pinnacle with 30 % of the sales tax revenue generated by Pinnacle and received by the City with the remaining balance of 70% retained by the City. The duration of the current agreement is for 10 years commencing in July of 2007 and slated for termination in June 2017, unless the parties enter into the new Agreement. To date, the City has received approximately \$4.0 million in sales tax revenue as a result of Pinnacle's operation and revenue generated.

3. A description of the economic development subsidy, including the estimated total amount of the expenditure of public funds by, or of revenue lost to, the local agency as a result of the economic development subsidy.

Economic Development Strategy Implementation and Business Retention

In furtherance of the City's economic development strategies, a revenue sharing Agreement in the form of the Operational Covenant Agreement is being proposed. Pursuant to AB562 the revenue sharing Agreement is defined as an Economic Development Subsidy that is an expenditure of public funds or loss of revenue to a local agency in the amount of one hundred thousand dollars (\$100,000) or more, for the purpose of stimulating economic development within the jurisdiction of a local agency, including, but not limited to, bonds, grants, loans, loan guarantees, enterprise zone or empowerment zone incentives, fee waivers, land price subsidies, matching funds, tax abatements, tax exemptions, and tax credits. Economic Development Subsidy shall not include expenditures of public funds by, or loss of revenue to, the local agency for the purpose of providing housing affordable to persons and families of low or moderate income, as defined in Section 50093 of the Health and Safety Code. The City and Pinnacle are currently in a revenue sharing agreement which the parties propose to amend and extend. The current agreement began in July of 2007 and is set to expire with the proposed new Agreement. To date, the City has received approximately \$4.0 million in sales tax revenue as a result of Pinnacle's operations.

The City is being reactive in retaining Pinnacle as one of the major contributors to the City's general fund. The City economic development strategies recognize the vulnerable economic recovery the Nation and City are experiencing. The potential relocation of Pinnacle and total loss of revenue would be much more detrimental and undermine the

City's delicate economic recovery and cause significant impact to services. The City is making a significant commitment to maintain the economic momentum it has gained over the past 12 months.

The City and Pinnacle propose to enter into a new Agreement that would extend the commitment by Pinnacle to remain in the City for up to fifteen (15) additional years. The Agreement provides for a sales tax sharing structure that would provide Pinnacle with up to 65 percent of the sales tax revenue generated by Pinnacle and the City 35 percent. It is estimated that the Agreement will provide Pinnacle with approximately \$7.4 million and the City \$5 million over a ten (10) year period. Should the parties agree to extend the Agreement for the five (5) year option term, Pinnacle will receive a cumulative amount in revenue sharing of approximately \$12.0 million and the City \$8 million over fifteen (15) years of the extended Operating Period.

4. A statement of the public purposes for the economic development subsidy.

Public Purpose

Review of the Agreement and proposed revenue sharing between Pinnacle and the City is consistent with the City's economic goals and strategies and is in the best interest of the general public.

Economic goals and strategies include the following:

- Increase the economic competitiveness of Huntington Beach
- Increase the City's wealth and prosperity
- Maximize public revenues and economic development financing options
- Diversify the City's economic base and wage levels
- Outreach and support to existing businesses
- Maintain and enhancing a consistent, business-friendly environment
- Expand public-private partnership opportunities
- Maintain current and provide future City public Services, capital projects and maintenance

The loss of redevelopment has had significant fiscal impact on City revenues and eliminated the primary local economic tool. Retaining Pinnacle's business operations in the City would address the need and desire to maintain revenue streams such as property and sales tax to the City. Additionally, Pinnacle's continued presence in the City would assist in maintaining relative balance in the local economy through indirect retail sales and employment from other local businesses that are supported by Pinnacle's location in the City. Retention of Pinnacle will also result in maintaining occupied property square footage thus minimizing the risk of blight and dilapidation.

The operating covenant and revenue sharing Agreement assists Pinnacle in the following areas:

- Decline in competitiveness due to industry consolidation
- Update current Tax Sharing Agreement Terms to allow Pinnacle to remain competitive
- Early capture of future growth in product sales (leveraging on estimated future revenue or industry price increases)

Pinnacle has identified multiple instances where larger competitors, created by significant consolidation of operators in the industry, have prevailed over Pinnacle by providing prices at significantly lower than Pinnacle's product costs. In recent months there have been a number of smaller operations that have been purchased by larger companies. These acquisitions have made it difficult for many of the remaining smaller operations to submit competitive price quotes for new business contracts. Larger companies are positioned to offer lower bid prices, thus creating a challenging environment for operations similar to Pinnacle to remain viable.

Pinnacle and the City concur that the current Tax Sharing Agreement between the City and Pinnacle is not reflective of the current industry standards or requirements for competitiveness. Tierra West has reviewed comparable agreements between companies and communities and noted substantial support for revenue sharing agreements of 65 percent. Pinnacle, as well as, overall industry forecasts project significant growth in sales revenue over the next five (5) and ten (10) years. City staff and Pinnacle agree that early capture or the ability of Pinnacle to accelerate increases in revenue through the proposed Agreement will allow it to be more competitive with contract pricing and operations.

5. Projected tax revenue to the local agency as a result of the economic development subsidy.

Based on the current City and Pinnacle Sales Tax Sharing Agreement, the City has received approximately \$4.0 million in sales tax revenue as a result of Pinnacle's operations in Huntington Beach. Based upon the proposed Operating Covenant Agreement, it is estimated that the City will receive an additional \$5 million during the first ten (10) years of the new Agreement. Should the parties agree to extend the Agreement for the additional five (5) year term; the City will receive \$8 million over fifteen (15) years of the extended Operating Period.

6. Estimated number of jobs created by the economic development subsidy, broken down by full-time, part-time, and temporary positions.

Pinnacle Petroleum, Inc. was founded in Huntington Beach in 1995 and moved to Seal Beach in 1998 and remained there for 10 years. Seal Beach provided a revenue sharing agreement to entice Pinnacle to move from Huntington Beach to Seal Beach. Pinnacle and Huntington Beach entered into a Sales Tax Agreement in July 2007 and Pinnacle agreed to relocate its headquarters back to Huntington Beach along with its 10 full time employees. Pinnacle has increased its employee base in the City by 300% and now has 30 full time employees. Based upon projected Pinnacle sales growth, over the term of the Agreement it is estimated that Pinnacle will increase employment in the City by approximately 8% per year. Over the initial 10 year term Pinnacle is anticipated to increase from 30 to 62 employees. Assuming Pinnacle and the City extend the Operating

Covenant Agreement for the five (5) year option; Pinnacle's employee base could potentially reach 91 at year 15.

Summary

Pinnacle Petroleum, Inc. (Pinnacle) and the City have agreed that Pinnacle remaining in Huntington Beach is beneficial for both parties. The City has proposed that Pinnacle agree to an Operating Covenant Agreement (Agreement) to remain in Huntington Beach for the next fifteen (15) years. Pinnacle and the City have mutually agreed to a revenue sharing structure in exchange for the Operating Covenant that also provides Pinnacle a more competitive advantage in an industry that is consolidating. The revenue sharing Agreement is the economic development subsidy that is consistent with the City's economic development implementation strategy and as prescribed in AB 562. Assistance is provided in the form of a revenue sharing agreement between Pinnacle and the City. The Agreement provides for Pinnacle receiving 65% of the sales tax revenue generated by Pinnacle's operation with the balance of 35% going to the City. The proposed Agreement will be for ten (10) years and could be extended for an additional five (5) year operating period upon the same terms and conditions for a total of a fifteen (15) year Operating Covenant. The estimated amount of the total subsidy or expenditure of public funds would be \$7.4 million over a ten (10) year period. Should Pinnacle and the City extend the Agreement for the five (5) year term, Pinnacle could receive a cumulative amount in revenue sharing of approximately \$12.0 million through year fifteen (15) of the extended Operating Covenant period.

Based upon review of the Agreement, the structure is consistent with the City's economic goals and implementation strategy is in the best interest of the general public. The Agreement and projections indicate the City will receive approximately \$5.0 million in sales tax revenue during the first of ten (10) years of the Agreement; including the five (5) year extension under the Agreement, the City will receive approximately \$8 million in total through the extended Operating Covenant period.

The Agreement serves a valid public purpose through the expansion of economic development opportunities for businesses in the City, continuing to expand the City's employment base, and continuing to generate sales tax revenue that the City utilizes to fund general governmental services for businesses and residents.

Recommendation

Retention of Pinnacle in the City will continue to contribute to the economic vitality of the City, continue to provide additional jobs within the City, continue to expand the City's tax base and improve economic and physical conditions in the City. Loss or relocation of Pinnacle out of the City will impact a vulnerable economic recovery and momentum that the City is achieving and reduce City services. As such it is recommended that the Operating Covenant Agreement be approved.

By its approval of the Agreement, the City Council of the City of Huntington Beach finds and determines that the Agreement serves as a valid public purpose through continuing to expand economic opportunities for businesses in the City, continuing to expand the City's employment base, and continuing to generate Sales Tax that the City will utilize to fund general governmental services such as police, fire, street maintenance, and parks and recreation programs.