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O'Brien: New Netflix headquarters in Los Gatos marks a new company town

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While less heralded than recent expansions announced by Google (GOOG), Apple (AAPL) and Facebook, Netflix (NFLX) is making plans for a larger headquarters in its historic home of Los Gatos to accommodate the

company's breakneck growth.

More than just reflections of the success of these tech giants, this spate of announcements illustrates a remarkable new phenomenon: Silicon Valley is becoming home to a new breed of company towns.

For municipalities, such growing companies would seem to be just what the economic doctors ordered in a time of tight budgets. Bigger companies should generate more taxes that help pay for local services. And yet, most of these new company towns are still struggling each year to balance their books.

That got me wondering: Does having such a titan help fill the town's tax coffers — and how?

That's harder to answer than you might think. That's because sales taxes paid by these companies are private

under state law.

But Netflix has allowed Los Gatos officials to disclose its sales tax payments, making it an interesting case study about this issue.

After reviewing Los Gatos planning documents, reading its "Comprehensive Annual Financial Report," and speaking extensively with town manager Greg Larson, the bottom line came as

quite a surprise: If the expansion is approved, Netflix may pay less taxes over time to Los Gatos.

That's not because Los Gatos offered tax breaks or

crazy incentives to keep Netflix. It has to do with the state's strange sales tax rules, and Netflix's changing business.

Even so, Los Gatos planners rightly believe it would be worse to not have Netflix and the taxes it will continue to pay. They argue that the indirect economic benefits and the intangibles of having a world-class consumer company like Netflix in town are more than worth it.

"Having a class A headquarters like Netflix here just complements that high-quality brand statement that is Los Gatos," Larson said.

The rapid growth in recent years of other valley tech titans has created a series of these new company towns up and down the region:

- Cupertino: As Apple has exploded over the



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past decade, it's become the dominant local employer, the largest contributor of sales tax revenue, and chips in an estimated \$500,000 in property taxes to the town.

- **Mountain View:** While Google has gone from zero to the town's largest employer over the past decade, it's not among the top 20 sources of sales tax revenue. However, through property taxes and fees for land it leases from the town, Google generates \$14.9 million in taxes for the town's general fund of \$90 million.
- **Redwood City:** Economic development officials are at pains to point out that the town is about more than just this software giant. But even though Oracle (ORCL) jobs declined in town recently, it still accounts for 17.1 percent of the city's employment.
- **Menlo Park:** The decision by Facebook to leave Palo Alto and buy the old Sun Microsystems campus makes Menlo Park the next candidate for company town status. While the company will no doubt increase property tax payments, it's unlikely to generate much in the way of sales taxes. The proposed new headquarters for Netflix is smaller than these other projects. But the expansion would have a dramatic impact on the town of Los Gatos, with its population of 29,413 and annual budget of \$30.8 million. The company told the town that with 900 Netflix employees, it's bursting at the seams. Netflix currently occupies two buildings at the southeast corner of Winchester Boulevard and Highway 85 and has teamed up with a developer who purchased nine buildings on the southwest corner of Winchester and 85. The rezoning application filed by the developer suggests the land could have as many as five office buildings with room for 2,000 to 2,200 employees. A Netflix spokesman declined to comment. Developer John Shenk said the company needs room to expand soon. "Los Gatos is in the very enviable position

of having a top-rated company asking to stay and to grow locally," Shenk said. The proposal has generated some controversy, in part because the original proposal included several five-story buildings for Netflix that would be among the tallest in town, and an option to build some residential development if all the office space is not built. However, most observers expect it to be approved in some form eventually. Netflix's success has been good for Los Gatos. In 2009, the company paid \$2.5 million in sales tax to Los Gatos. Last year, the Los Gatos community received \$3.2 million in taxes from Netflix, including about \$400,000 in property taxes and most of the balance from sales taxes. "If Netflix were bought by Amazon, that would be a 10 percent hole in my budget," Larson said. So with Netflix growing like gangbusters, why won't Los Gatos reap a windfall of new tax revenues? That's because while the company pays sales taxes on its DVD rental business, it doesn't on revenues from streaming movies online. As its business model shifts to streaming, Larson expects its sales taxes will decline about 20 percent each year. Indeed, a recent controversial move by Netflix to separate is DVD and streaming subscriptions could cut its sales tax

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payments to Los Gatos by 25 percent to 50 percent, according to Larson. Larson has known this day was coming and took careful steps to prevent the town from becoming addicted to Netflix taxes. Los Gatos has only been using the money from Netflix to pay for various one-time capital projects, while stashing about half in a rainy-day fund. Larson projects that the new development could bring an additional \$1.5 million to \$2 million in property taxes to the Los Gatos community beyond the \$400,000 Netflix currently pays. And as an e-commerce company, the amount of its business license fee would increase to \$170,000 or more. Of course, if Netflix left, or expanded elsewhere, Los Gatos would get nothing. Indeed, the expansion will help offset some of the lost sales tax revenue. Bottom line: If everything breaks just right for Los Gatos, the tax payments from Netflix and the new development might eventually settle at \$2.6 million annually, just shy of the current \$3.2 million. Larson emphasizes that the company's value can't just be measured by its tax receipts. The company provides high-paying jobs to people who, hopefully, shop and eat in Los Gatos. And then there is the enhancement to the town's reputation. Doug Henton, of Collaborative Economics, says Larson is right. The slew of new headquarters is a positive endorsement of Silicon Valley. "They attract other companies because they're here," Henton said. "It creates a labor force that moves around, and possibly even starts other companies. It creates a vibrant cluster that's good for the region. I can't think of any negatives as to why you wouldn't want to have them." I don't dispute that you'd rather have a Netflix than not have a Netflix. But as the Netflix example shows, towns need to take careful steps to manage this new dependency. And unfortunately, we also shouldn't expect that this frenzy of new

developments, and all these new corporate giants in our midst, are going to stop the bleeding in local government budgets that continues to plague this region. Contact Chris O'Brien at 415-298-0207 or cobrien@mercurynews.com. Follow him at [Twitter.com/sjacobrien](https://twitter.com/sjacobrien) and read his blog posts at www.siliconbeat.com.



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