Agenda Report

January 29, 2018

TO: Honorable Mayor and City Council

FROM: Department of Finance

SUBJECT: PROPOSED FISCAL STRATEGY TO MAINTAIN CITY SERVICE LEVELS AND ADDRESS NEEDED CAPITAL INVESTMENT

RECOMMENDATION:

It is recommended that the City Council endorse the proposed fiscal strategy outlined in this report to maintain City service levels and address needed capital investment and direct staff to return to the City Council as appropriate to proceed with a revenue measure and an advisory vote on the November 2018 ballot.

BACKGROUND:

As outlined in the Mayor's State of the City speech, since 2009, in order to balance the General Fund budget, the City spent down its reserves by $25 million, eliminated 123 staff positions including 23 sworn police officer positions, made ongoing annual reductions exceeding $19 million, and shifted over $5 million in annual pension costs to employees. Despite these reductions, City service levels have remained largely unchanged owing much to City staff's ability to manage effectively with fewer resources.

Moreover, over the past few years, the City has rebuilt and, in fact, increased its General Fund reserve levels to meet the fund balance policy goal of 20 percent, totaling more than $47 million as of June 30, 2017. This was achieved largely through the use of one-time or limited-term revenues. In addition, the City Council authorized the creation of an IRS Section 115 Trust to set aside funds for future pension and other post-employment benefit liabilities with an initial deposit of $12 million.

Despite these efforts to secure the City financially, General Fund revenues are not growing sufficiently to offset increases in operating costs, despite the positive national economy. Consequently, the General Fund Five-Year Forecast anticipates a growing operating deficit out into the future (Attachment A).

As indicated by the Five-Year Forecast, while Property Tax has grown steadily as a result of new development and re-assessments resulting from changes in property ownership, the General Fund's other major revenue sources, Utility Users Tax and Sales Tax, have been flat or have actually declined in recent years.

Property Tax has been the strongest revenue source for the General Fund since Fiscal Year 2009, when it overtook sales tax at the start of the Great Recession. Since that time, property tax has continued to grow from roughly $35 million to $62 million annually. About $7 million of this growth is directly tied to the elimination of redevelopment and a shift of some property tax revenues to the General Fund, but the majority of the growth is directly related to new development, valuation increases, and the new valuations of purchased properties. Sales tax on the other hand has been lagging since the end of the Recession. In 2008, sales tax generated approximately $35 million in revenue and dipped to a low of $28 million in 2010. For 2018, the City is expecting to receive $34.5 million based on the most recent projections. Unfortunately, the loss of several significant tax generating businesses over the past decade has greatly offset the growth that has been seen from other businesses. It is also important to note that investment earnings on the City's reserves and fund balance generated as much as five times more value in 2009 than today. Interest rates have remained at historic lows since that time and while General Fund investments are larger today, the investment income has been reduced by more than $8 million annually.

Since the Recession the City's General Fund expenditures have increased from $225 million to the current year budget of almost $237 million. This represents slightly more than 5 percent growth over a 10-year period. In Fiscal Year 2009, personnel costs accounted for 60 percent of the total General Fund budget; in Fiscal Year 2018 they now account for 63.6 percent. Despite significant increases to pension contributions over the past decade, along with the regular payroll growth arising from labor agreements, the relatively small percentage growth is evidence of the impact of previous budget reductions, position eliminations, and employee pension cost sharing. In dollars, total General Fund personnel has grown from $136 million to $150 million, a 10 percent increase over a 10-year period. Helping to offset these increases has been a significant reduction in debt service. Debt service for the General Fund has decreased from 13.2 percent of the budget in Fiscal Year 2008 to only 6 percent today, representing a decrease of $16 million annually. Aside from these two categories, the remaining General Fund categories of expenditures have remained largely the same over the past 10 years.

Addressing the anticipated operating shortfall is the most urgent financial concern for the City. However, a plan must also be developed to address the City's ever-growing backlog of capital repair and maintenance needs. The level of spending on repair and maintenance has been deficient for more than a decade with critical City facilities such as fire stations needing upgrades to ensure their day-to-day functionality as well as their performance following any significant seismic event. The level of annual funding needed to maintain streets at an acceptable level is $7 million, and even with the recently approved increase to Gas Tax under Senate Bill 1, which may be the subject of a recall election later this year, the City has an annual shortfall in funding of $3 million per year. City sidewalks, community centers, and libraries are also in need of investment far greater than current fiscal resources allow.

In order to balance the Fiscal Year 2018 Operating Budget, more than $4.1 million was cut from the budget through the elimination of 14 vacant positions and the reduction of various departmental operating budgets. Nevertheless, the current Five-Year Forecast indicates a deficit of approximately $3.5 million for Fiscal Year 2019, which grows to an estimated $12 million in 2023. Accordingly, the instructions provided to departments as they begin to formulate their operating budgets for next fiscal year, is to identify reductions necessary to close the gap for Fiscal Year 2019 and beyond. After nearly ten years of incremental reductions, which have staved off any significant service reductions, the Recommended Fiscal Year 2019 Operating Budget will most certainly include the reduction or elimination of City services. The harsh reality is that the budget cannot be trimmed each year while service levels and programs remain at existing levels, particularly as the cost of operations and staffing continue to rise.

The current year General Fund operating budget is $236.8 million. Of that, $41.7 million is obligated for debt service; the Pasadena Center Operating Company and the funding of the Library system as required by the Special Library Tax. Of the remaining $195.1 million, $116.6 million, or nearly 60 percent, is for public safety services of Police and Fire. The following table illustrates General Fund appropriations.

Department	General Fund 2018 Budget (in millions)
City Attorney	$6.802
City Clerk	$2.450
City Council	$2.397
City Manager	$5.003
Finance	$10.246
Fire	$44.958
Housing	$1.221
Human Resources	$4.312
Human Services & Recreation	$11.027
Libraries & Information Services*	$11.129
Planning & Community Development	$7.684
Police	$71.623
Public Works	$21.577
Transportation	$5.741
Non-Departmental*	$30.577

* Combined total the $41.7 million of legally obligated funding stated above.

Closing the budgetary gap will necessitate the continued close examination of existing City services. For example, the Fire Department has a current General Fund operating budget of roughly $45 million and a staffing complement of 182.50 full time equivalents. The department operates 8 fire engines, 2 fire trucks, and 5 rescue ambulances and responds to approximately 19,500 unique incidents per year, nearly 80 percent of which are categorized as medical calls. Given the deployment and staffing arrangements for the department, there are limited opportunities to reduce costs.

One of the few options that has been identified is the possible restructuring of emergency medical service delivery. Currently, the department operates Advanced Life-support ambulances staffed by Fire Fighter Paramedics. Other agencies, such as neighboring Glendale, operate Basic Life-support ambulances staffed by non-Fire-Fighter Emergency Medical Technicians (EMT).

Accordingly, in order to better understand possible alternative service delivery models for emergency medical services, staff has issued a request for proposals to engage a qualified consultant to explore in greater detail various options to better inform any future decision-making process. While it is anticipated that the Fiscal Year 2019 Operating Budget can be balanced without having to consider this particular change in service delivery, particularly until further analysis is completed, given the City's fiscal position, this is indicative of the type of considerations that will have to be made over the next few years unless another solution to addressing the City's budget challenges can be found.

As part of his State of the City Address, the Mayor suggested that a sales tax measure, along with continued fiscal discipline, could be a major part of that solution; one that would help the City balance its budget, maintain service levels, and reinvest in critical infrastructure. Staff concurs with this assessment.

As envisioned, a sales tax measure could be implemented through the voter approval of a Transaction and Use Tax district. Assuming the City moves forward to change its regular schedule for elections, such a vote could take place in November 2018. State law provides that individual jurisdictions (cities) may form one or more transaction and use tax districts as long as the total tax levy, including the rate of countywide districts, does not exceed two percent. According to the State Board of Equalization, agencies in Los Angeles County that do not currently have a transaction tax, have the ability to approve a tax measure up to three-quarter percent without the need for special legislation.

The current Los Angeles County tax rates breakdown is as follows:

State General Fund [1]	3.9375%
City/County General Fund (Bradley Burns) [1]	1.0000%
Public Safety (Prop 172) [1]	0.5000%
County Realignment (Mental Health/Welfare/Public Safety) [1]	1.5625%
Countywide Transportation Fund [1]	0.2500%
Los Angeles County Transportation Commission (Prop A) [2]	0.5000%
Los Angeles County Transportation Commission (Prop C) [2]	0.5000%
Los Angeles County Metro Transportation Authority (Measure R) [3]	0.5000%
Los Angeles County Metro Transportation Authority (Measure M) [3]	0.5000%
County of Los Angeles (Measure H) [2]	0.2500%
Total Rate	9.5000%

[1] Considered part of the state's base sales tax rate
[2] Tax counts towards the maximum 2.0 percent above the state's tax rate
[3] Tax has legislative exemption from the state's 2.0 percent cap

Since District Transaction and Use Taxes are applied differently than traditional sales tax, the generation of new revenue is not equal to what is currently received with the one percent Bradley-Burns sales tax allocation. Under the Bradley-Burns Tax Law, most retail sales are deemed to occur at the retailer's place of business in this state where the sale is negotiated. (Exceptions may include certain auctioneers, vending machine operators, and construction contractors). If the retailer has more than one place of business in this state, the sale is deemed to occur at the location where the principal negotiations take place. Generally, the combined one percent state and local sales tax portion of the statewide 8.25 percent sales and use tax is allocated to the jurisdiction where the retailer's place of business is located, and the local use tax is generally allocated through the countywide pool where the property is used.

For purposes of distributing the district tax, the tax generally follows the merchandise. That is, the tax is generally distributed to the district where the goods are delivered (and presumably used.) District tax distributions are, therefore, affected by the definition of *place of sale,* which relies on the following factors that also determine if district tax is applicable. If the conditions in (a) are not met, the retailer should look at (b) to see if he or she must collect and report the use tax.

a) Transactions (Sales) Tax - The retailer has a business location in the district, and the sale and delivery occur at that location.
b) District Use Tax
    - The retailer is engaged in business in the district.
    - The retailer has any kind of representative operating in the district for purposes of making sales or deliveries or for taking orders.
    - The retailer derives rentals from a lease of tangible personal property in the district.

- The retailer sells or leases vehicles, undocumented vessels, or aircraft that will be registered in the district.

The most common example for Pasadena is automotive sales. Vehicle purchases are taxed based on the vehicle's registration address, so the tax would only apply to those purchasing a vehicle with a Pasadena address on the registration, regardless of the city the vehicle was purchased. Therefore, most automobiles sold by Pasadena automotive dealers would not be subject to the tax.

Generally, a District Transactions and Use Tax generates less than the current Bradley-Burns one percent sales tax, and this would likely remain true for Pasadena. Based on the City's receipts for fiscal years 2016 and 2017, a local transaction tax of three-quarter percent would potentially generate $22.4 million during the initial year of implementation.

The following table outlines potential revenues obtained during the initial year of implementation based on various transaction tax rates of 0.75 percent or less.

Transaction Tax Category	Estimated 0.75% Transaction Tax $
Autos & Transportation	2,611,000
Building & Construction	1,440,000
Business & Industry	1,790,000
Food & Drugs	1,460,000
Fuel & Service Stations	1,186,000
General Consumer Goods	6,850,000
Restaurants & Hotels	5,454,000
County/State Pool	1,860,000
Admin Fees	(211,000)
	Total: $22,440,000

If implemented, a three-quarter percent District Transactions and Use Tax would be utilized to support on-going City services, including but not limited to Police, Fire, Public Works, Recreation, and after school programs. In addition, it is envisioned that a portion of the funds would support capital investments in City facilities and infrastructure such as fire stations, community centers, and libraries as well as repair damaged and broken City sidewalks. For example, if roughly one-third of the revenues were to support infrastructure, depending on interest rates and duration, it could generate approximately $100 million in proceeds from a financing towards much needed repair and maintenance.

Finally, the Mayor has suggested an advisory vote that would provide for one-third of revenues received by the tax to be shared with the Pasadena Unified School District (PUSD) to provide direct support for classroom instruction and reduce the impacts of the significant budget reductions the District has been required to make in recent years.

The link between the City's prosperity and the success of its local school district was recognized in 2012 by the task force that was established to further the City's Economic Development Strategic Plan. The task force acknowledged that PUSD's steady progress in increasing test scores and the quality of its efforts to prepare students for an innovation economy is critical to the City's economic success. The quality of local public schools is a major factor in attracting talent to Pasadena's businesses. Although PUSD has seen its test scores rise demonstrably over the last decade, recruits to some of the City's key sectors still weigh the potential cost of private school when considering whether to accept an offer from local firms.

SUMMARY:

Since the Great Recession, the City has made significant cost reductions with little obvious service reductions. Unfortunately, further reductions will be necessary as a result of rising operating costs and stagnant revenue growth. These future reductions will certainly impact services the community has come to rely upon. Asking residents to vote on a proposed revenue measure is perhaps the best way to determine whether a majority of voters wish to maintain City services at their current level, as well as repair and maintain aging infrastructure, or whether they favor a reduction in service levels to meet the available level of financial resources.

Accordingly, staff is recommending that the City Council endorse the proposed fiscal strategy and direct staff to return to the City Council as appropriate to proceed with a revenue measure and an advisory vote on the November 2018 ballot.

COUNCIL POLICY CONSIDERATION:

The proposed action is consistent with the City Council's strategic planning goal to maintain fiscal responsibility and stability.

ENVIRONMENTAL ANALYSIS:

The action proposed herein is not a project subject to the California Environmental Quality Act (CEQA) in accordance with Section 21065 of CEQA and State CEQA Guidelines Section 15060 (c)(2), 15060 (c)(3), and 15378. Since the action is not a project subject to CEQA, no environmental document is required.

FISCAL IMPACT:

The General Fund has a projected deficit of $3.5 million for Fiscal Year 2019 and the deficit is projected to grow to more than $12 million by Fiscal Year 2024. The approval of a District Transactions and Use Tax of three-quarter percent by the voters is estimated to generate more than $22 million annually. This new revenue source combined with future growth in other key revenue sources such as Transient Occupancy Tax from short-term rentals and new hotels would help secure the City's financial position for the future.

If a measure is put before the voters in November 2018, the City would collect approximately three months of revenue in Fiscal Year 2019, as there is a delay in tax reporting and collection. The City would receive a full year's worth of tax revenue beginning in Fiscal Year 2020.

Respectfully submitted,

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Approved by:

STEVE MERMELL
City Manager