Agenda Report

March 5, 2018

TO: Honorable Mayor and City Council

FROM: Department of Finance

SUBJECT: **PROPOSED FISCAL STRATEGY TO MAINTAIN QUALITY CITY SERVICE LEVELS AND ADDRESS AGING INFRASTRUCTURE NEEDS**

RECOMMENDATION:

It is recommended that the City Council endorse the proposed fiscal strategy outlined in this report to maintain quality City service levels and address aging infrastructure needs and direct staff to return to the Council as appropriate to place a revenue measure and a separate advisory vote on the November 2018 ballot.

EXECUTIVE SUMMARY:

On January 29th staff presented a proposed fiscal strategy to maintain City service levels and address aging infrastructure needs. Over the past several years, the City has made significant cost reductions including:

- Elimination of 123 staff positions including 23 sworn police officer positions
- Significant budget cuts exceeding $19 million annually, and
- Pension reform to shift over $5 million in annual pension costs to employees

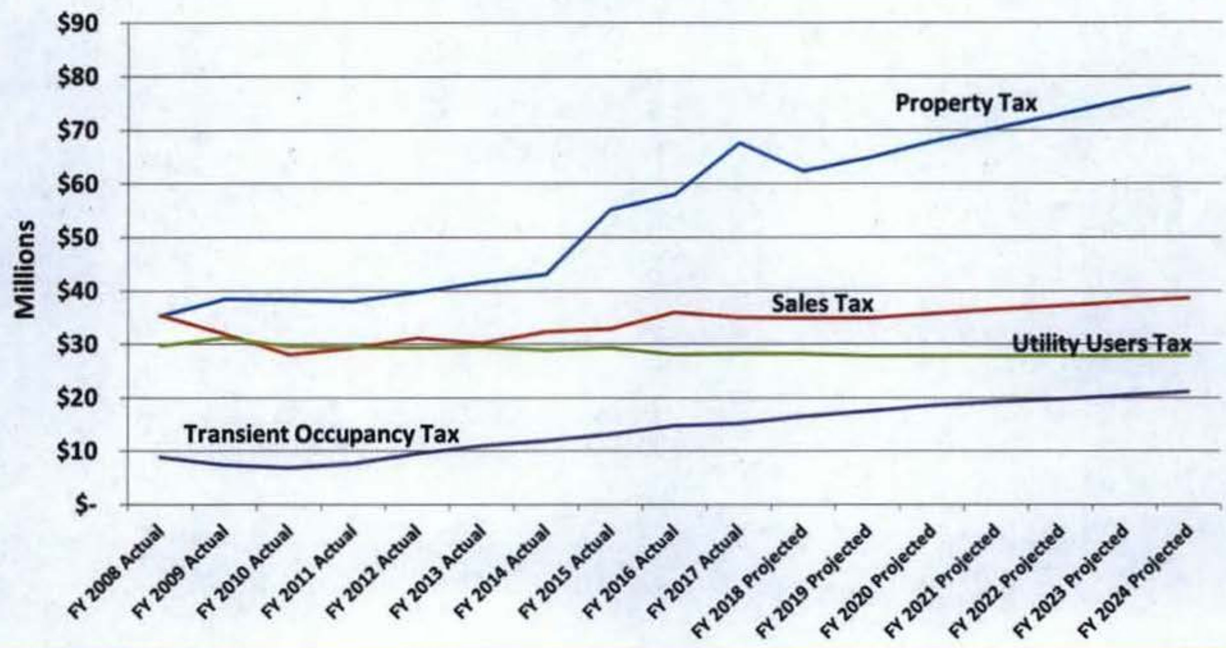
Moreover, in the last five years alone, Pasadena has lost over $130,000,000 from Sacramento budget raids and cuts. At the same time, there is higher demand for City services. Consequently, the City is facing a significant financial challenge to maintain existing levels of the services our public expects and deserves, as well as make needed investments in its critical infrastructure including fire stations, community centers, emergency 911 response, streets and sidewalks. Based on current projections, the City will need to reduce expenditures and associated service levels in the General Fund by $3.5 million in fiscal year 2019. Furthermore, additional reductions will be necessary in future years to maintain a balanced budget and avoid the need to draw down the City's emergency contingency reserves.

This report is intended to provide additional information and respond to the questions raised by Councilmembers on January 29th.

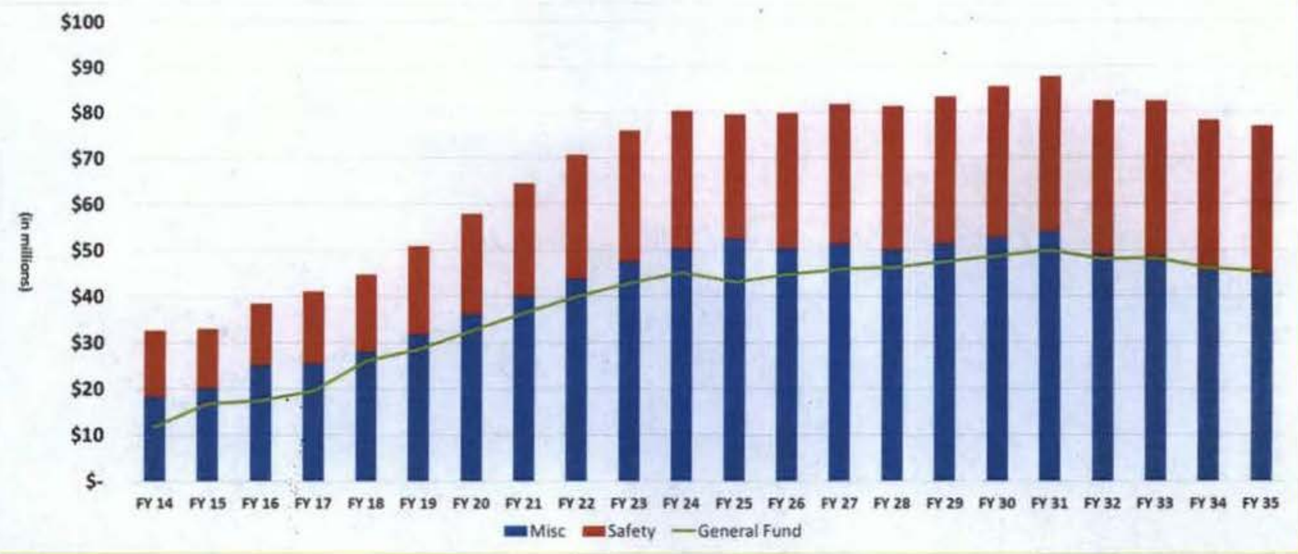
<u>BACKGROUND</u>:

Thanks to the leadership of the City Council and the City's tradition of accountability and careful stewardship of public dollars, the City of Pasadena is currently fiscally sound. The City enjoys a credit rating of AAA on its General Obligation debt from Standard and Poor's and this past year fully funded its General Fund 20% emergency contingency reserve that serves as a bulwark against the enviable economic recession or natural disaster.

However, in spite of reductions made last fiscal year, which totaled $4.1 million and involved the elimination of 14 Full Time Equivalent staff positions, the General Fund Five Year Financial Forecast indicates that operating expenditures will exceed annual revenues next fiscal year and each year into the future unless action is taken. There are several factors contributing to this. While property tax revenues have grown considerably in recent years, growth in the other key revenue sources of sales tax and utility users tax has been rather stagnant owning to changes in technology and shopping habits. These trends are expected to continue into the future.



On the expense-side, there is no doubt that increased required annual contributions to the CalPERS retirement system are having a significant impact. The following table, based on the most recent actuarial analysis performed by CalPERS, highlights the City's currently anticipated contribution rates to the retirement system into the future.



Pasadena is not alone in this. A recent report by the League of California Cities found that across California, legally-obligated pension costs will dramatically increase to unsustainable levels over the next few years; rising pension costs will require cities to nearly double the percentage of their General Fund dollars they pay to CalPERS, and cities have few options to address growing pension liabilities. As part of its report, the League also suggested steps cities can take to help offset the impact of increased pension contributions. The City of Pasadena has implemented several of these recommendations including:

- Establishment of an IRS Section 115 trust, with an initial deposit of $12 million, to save towards further liabilities
- Shifting of over $5 million in annual pension costs to employees
- Pre-paying annual CalPERS obligations to reduce the Unfunded Actuarial Liability

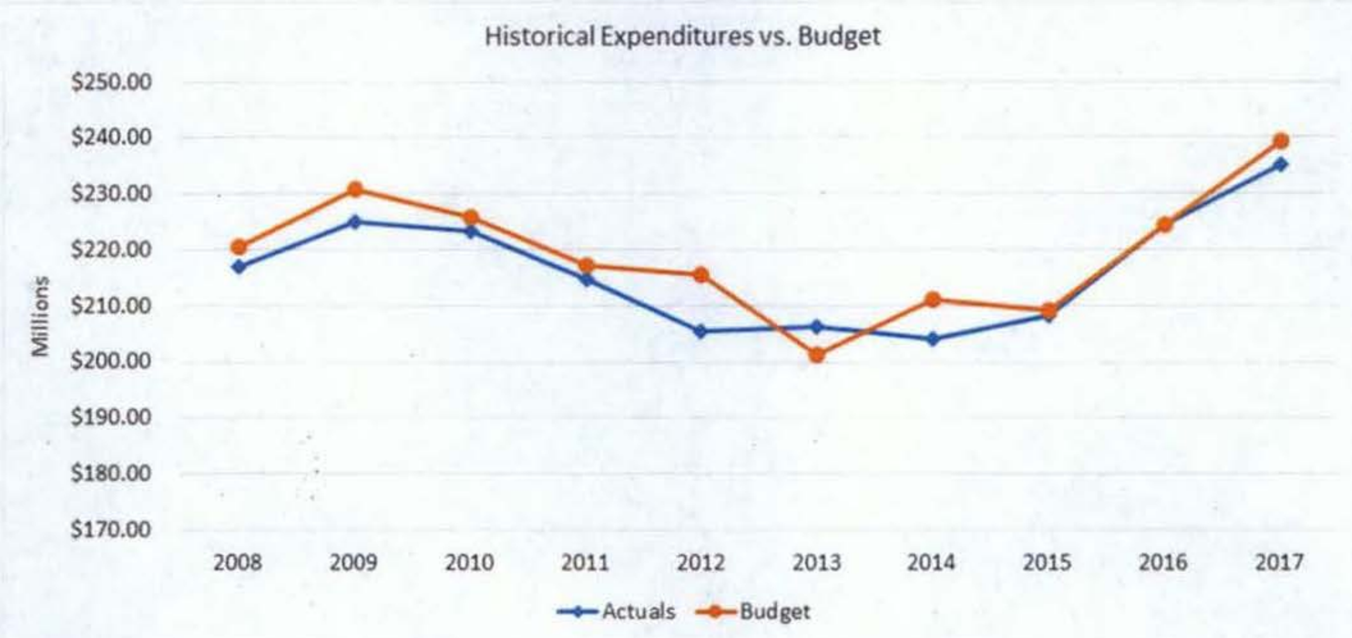
Moreover, as the City's workforce changes over time, more employees will be covered by the more modest retirement benefit formulas of the Public Employees' Pension Reform Act (PEPRA), which applies to CalPERS enrollees hired after January 1, 2013. Currently, 25% of the City's workforce is covered by PEPRA.

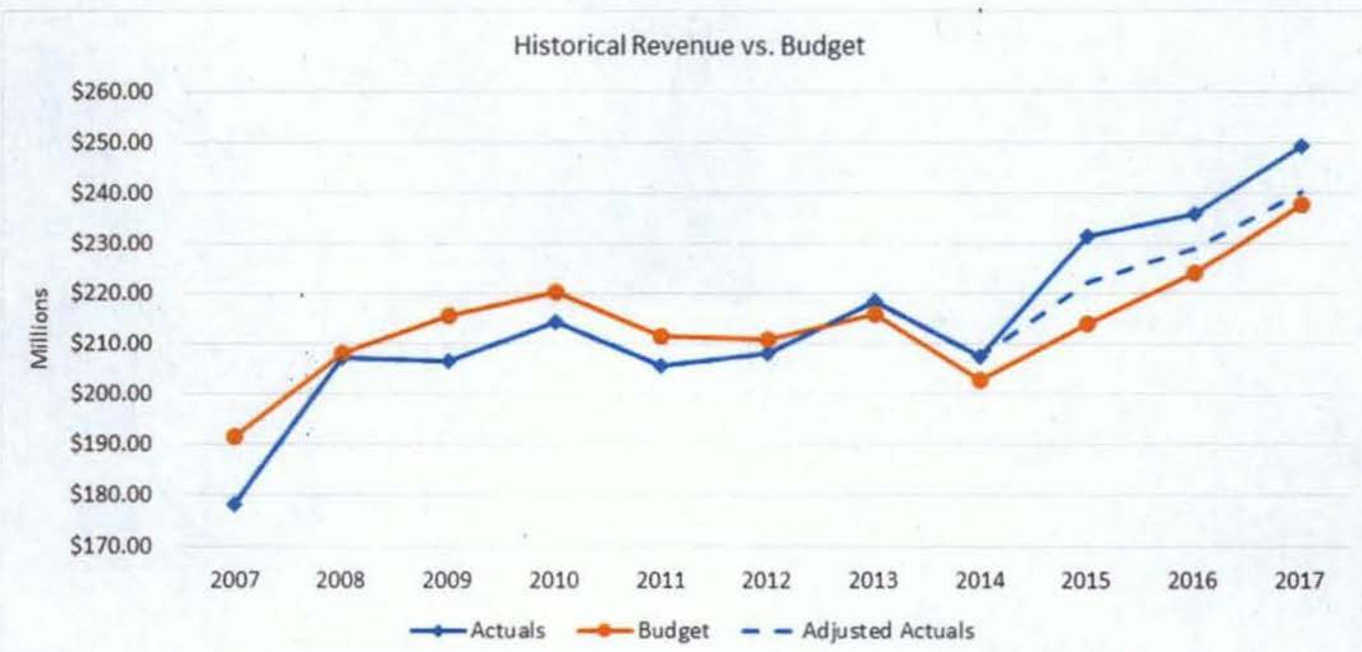
Nonetheless, taken as a whole, the City's projected revenues and expenses show a mismatch over the life of the City's current Five Year Forecast, with expenses outstripping revenues by $32 million over the next five years. While these projections tend to be somewhat conservative, the chart below graphs projected vs. actual financial results for the General Fund in recent years, the trend is clear, the City's expenses are exceeding available revenues. Faced with such a structural deficit there are few options, which need not be mutually exclusive. The City can:

- Maintain service levels and draw down its reserves to balance future budgets. Such an approach may be acceptable in the short term assuming significant revenue growth is expected in future years.

- Reduce City services to a sustainable level given revenue constraints.

- Seek to enhance revenues to maintain service levels.





The adjusted actuals line on the chart above takes in to account adjustments for one-time revenues. These one-time revenues included lawsuit settlement proceeds, insurance settlement proceeds, redevelopment dissolution, and the unwinding of the sales tax triple-flip, which will not reoccur in future years.

Perhaps more significant than the fiscal challenges associated with the Operating Budget, is the City's significant and ever-growing need for investment in its infrastructure.

The current Capital Improvement Budget has identified nearly $1 billion in needed capital improvements. However, to date funding has been identified to fund only about half this amount. Moreover, in certain key areas the deficiency of funding poses a significant problem for the City. The following are but a few notable examples:

- As of June 30, 2017 the City had approximately 822,000 square feet of damaged sidewalks in need of repair. Funding to complete this work, which is estimated to exceed $12.4 million, has not been identified.

- The radios utilized by the Pasadena Police and Fire Departments to respond to emergency 911 calls for service have reached the end of their useful ten-year lifecycle and are in need of replacement. The estimated cost to replace these radios is $8 million. If done on a lease-financing basis, the annual cost to the General Fund for a seven-year financing would be approximately $1.2 million per year. Funding has not been identified.

- Upgrades to five of the City's eight fire stations which are necessary to meet current operational needs remain unfunded as does the seismic upgrade to the City's Public Works building.

In order to identify a sustainable funding stream to address these and other critical infrastructure needs as well as maintain existing service levels, staff is recommending that the City Council endorse a fiscal strategy that maintains fiscal discipline and considers asking voters to approve new revenues.

Over the past ten years, a number of southern California cities have obtained voter approval for local sales tax measures to support City services and it is anticipated that several other cities will follow suit over the next year or so, as locally-enacted measures are not subject to raid or seizure by the State. By law, all funds must be locally-controlled.

City	Local Tax %	Year Approved by Voters
Commerce	0.5	2012
Compton	1.0	2016
Culver City	0.5	2012
Downey	0.5	2016
El Monte*	0.5	2008, 2013, 2017
Inglewood	0.5	2006
La Mirada	1.0	2012

Long Beach	1.0	2016
Lynwood	1.0	2016
Pico Rivera	1.0	2008
San Fernando	0.5	2013
Santa Monica**	1.0	2010, 2016
South El Monte	0.5	2010
Southgate	1.0	2008

*El Monte voters extended the term of the tax in 2013 and 2017
**Santa Monica voters increased the tax from 0.5% to 1.0% in 2016

Beyond responding to the same fiscal pressures that exist in Pasadena, cities will likely be motived by the fact delay may cause them to lose the opportunity to ask voters to approve a local revenue measure. Under current state law, the maximum sales tax for a local jurisdiction in Los Angeles County is 10.25%. It should be noted that the recent Los Angeles County Metro Transportation Authority Measures R and M were exempt from this cap. Consequently, since the current total sales tax rate in Los Angeles County is 9.5% including Measures R and M, the maximum additional sales tax voters in a City in the County of Los Angeles could enact would be 0.75%. In the event the County were to put forward a successful sales tax measure in future years, cities including Pasadena, may find themselves without the option of allowing their respective voters to consider this type of measure, as no increment will remain. In fact, the County is considering a November 2018 measure related to storm water; however, it will most likely be in the form of a property-based parcel tax.

Additionally, in late February the League of California Cities advised of a proposed ballot initiative, targeting the November 2018 election as well, that would make all local taxes, whether they be for general or special purposes, subject to a 2/3rds approval threshold retroactive to January of this year. Staff, through the League, is closely monitoring this effort and will advise the Council if it qualifies.

As was discussed at the February 15th joint meeting between the City Council and the Pasadena Unified School District's Board of Education (PUSD), the PUSD is currently facing its own, more significant, fiscal crisis. As outlined by the Superintendent, the District must make $7 million in reductions in the current fiscal year and nearly $12 million the next in order to remain solvent. Quality public schools and education have long been identified by our residents as priorities.

The situation with the PUSD creates uncertainty for several programs operated by the City at PUSD facilities, such as the aquatics program. The City and PUSD have been partners for afterschool and summer recreation programs and jointly manage certain facilities. The elimination of current PUSD programs or the closure of PUSD facilities may put pressure on the City to provide additional programming. Additionally, as was discussed at the joint meeting, City staff will actively engage in discussions with PUSD executive management regarding potential opportunities to leverage District assets for the potential benefit of both the District and the City.

On June 12, 2017, staff presented the City Council with several options for potential local revenue enhancements to maintain quality services and invest in aging infrastructure. In addition to a local sales tax, these options included: General Obligation Bonds to fund capital projects, Parcel Tax, Real Property Transfer Tax, Parking Tax, Business License Tax, Transient Occupancy Tax, Utility Users Tax, Excise Tax, and Assessment District. The following is a brief explanation of each:

Property Tax – General Obligation Bond

Uses: Capital projects only, cannot be used for operating costs
Voter approval threshold: Two-Thirds

As of Fiscal Year 2018, the City's annual property tax revenue is approximately $61.4 million. Property taxes are the primary source of revenue for the General Fund. Property values have increased since the 2008 economic downturn resulting in increased revenue for the General Fund.

With the passage of Proposition 13 in 1978, property taxes are limited to one percent of a property's taxable assessed value and can only exceed this limit to pay for local government debts approved by the voters prior to July 1, 1978 or for bonds to buy or improve real property that receive two-thirds voter approval after July 1, 1978.

As a way of funding capital improvement needs, the City Council could seek voter approval for a General Obligation Bond to generate capital funds for a project or projects. The Police Building and Jail was financed in this fashion.

The following table illustrates the revenue that could be generated by various levels of property tax assessments and the value of those revenues capitalized for 20 or 30 years at a conservative interest rate of 4.5 percent.

The figures below assume a tax-exempt usage.

Amount per $100,000 Assessed Value $	Estimated Amount of Revenue per Year $	Value if Capitalized for 20 Years at an Interest Rate of 4.5% $	Value if Capitalized for 30 Years at an Interest Rate of 4.5% $
10	2,582,665	33,595,137	42,068,736
20	5,165,329	67,190,274	84,137,472
30	7,747,994	100,785,411	126,206,207
40	10,330,658	134,380,548	168,274,943
50	12,913,323	167,975,685	210,343,679
60	15,495,988	201,570,822	252,412,415
70	18,078,652	235,165,959	294,481,151

Based on total assessed value of $25,826,646,000. Reserve requirements and cost of issuance would reduce the net revenue to approximately 10 percent.

Parcel Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds

The origins of the parcel tax are also tied to Proposition 13; however, parcel taxes differ from property taxes in two significant ways. First, parcel taxes tax real estate parcels, not the value of those parcels. For example, property that is zoned single family residential pays the same tax amount regardless of the size or value of the lot or improvements.

The City's Library Special Tax is a parcel tax that like other parcel taxes has a different rate for differing property usage (i.e., single family, multi-family and commercial/industrial use). The following table contains current information on the Library Special Tax.

Parcel Type	Number of Parcels	FY 2018 Rate $	Revenue $
Residential	30,884	38.14	1,177,916
Multi Family	4,102	25.05	102,755
Non-residential	4,319	279.05	1,205,217
			Total: $2,485,888

For Multi-Family Residential, the basis is the number of residential units of a multi-unit building which is not a condominium (e.g., apartments).

The second way parcel taxes differ from property taxes is that they can be used for operating expenses, like the Library Special Tax; however, as with property taxes, two-thirds voter approval is required to implement a parcel tax.

The following chart illustrates the amount of annual revenue that could be generated at various rates. As with the Library Tax, a parcel tax rate may include annual increases based on the Consumer Price Index or other factors. If some type of annual increase provision is not included, a parcel tax for operating purposes would become less effective over time as revenues would not increase as operating expenses increase.

Parcel Type	Number of Parcels/Units	Rate $	Revenue $
Residential	30,884	25	772,100
Multi Family*	4,102	15	61,530
Non-residential	4,319	190	820,610
			Total: $1,654,240
Residential	30,884	45	1,389,780
Multi Family*	4,102	25	102,550
Non-residential	4,319	210	906,990
			Total: $2,399,320
Residential	30,884	65	2,007,460
Multi Family*	4,102	45	184,590

Non-residential	4,319	230	993,370
			Total: $3,185,420

*Number of assessable units.

City staff has been advised by its experts that in today's environment it is extremely difficult to pass any parcel tax in excess of $49 per parcel.

Real Property Transfer Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

The State of California Revenue and Taxation Code authorizes a fee on the transfer of real property ($1.10 per $1,000 of sale value). Through the adoption of Pasadena Municipal Code Chapter 4.36, the City currently receives half of this amount or $0.55 per $1,000 of sales value and the county receives the other half. Over the last two fiscal years, the Real Estate Transfer Tax generated an average of $1.3 million per year for the City. This revenue stream while stable and growing during periods of real estate growth and expansion, can realize sharp declines when the real estate market slows or contracts.

Cities are permitted to levy their own transfer taxes; however, it requires forfeiture of the current county share. The cities of Los Angeles and Culver City have a transfer tax of $4.50 per $1,000 valuation; Santa Monica's rate is $3 per $1,000 valuation; and Pomona and Redondo Beach are $2.20 per $1,000 valuation.

Using current average property sales amounts, a rate of $2.11 per $1,000 of sale value would net the City an additional $1 million dollars over the current level of receipts. Increases in increments of $0.23 would generate an additional $1 million dollars.

Rate	Gross Revenue $	County Share $	City Share $	Less Current Revenue $	Net Additional to City $
0.01055	4,621,017	2,409,061	2,211,956	1,204,531	1,007,426
0.01285	5,628,443	2,409,061	3,219,382	1,204,531	2,014,851
0.01515	6,635,868	2,409,061	4,226,807	1,204,531	3,022,277
0.01745	7,643,294	2,409,061	5,234,233	1,204,531	4,029,702

If the proceeds from a real estate transfer tax are used for general purposes, an approval by a simple majority vote is needed. If the proceeds are used for a specific purpose, it is a "special tax" pursuant to Proposition 218 and subject to a two-thirds voter approval.

Parking Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

Another revenue potential is a tax on paid parking spaces (not parking meters) in public and privately owned or operated parking garages and lots, somewhat akin to the Transient Occupancy Tax on hotel rooms. The City currently operates eight garages and three surface lots with a total of 6,500 parking spaces. There are approximately 11,000 privately controlled spaces that would be subject to the tax. Rose Bowl parking might also be a consideration and could add thousands of additional spaces during events with paid parking. Using actual revenue figures for City-controlled spaces and projections for privately controlled spaces at a tax rate of 10 percent, the City could generate up to $3 million annually. A caveat to this type of tax is that it is generally a fixed percentage tax, so unless parking rates are increased or the number of parking spaces increased, the revenue growth over time would be relatively flat.

Currently, the City of Los Angeles has a 10 percent parking occupancy tax, the City of Santa Monica has a 10 percent parking facilities tax, and the City of Burbank has a 12 percent transient parking tax which generates roughly $3 million per year.

Business License – Gross Receipts Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

The City's business license tax is based on one or more factors (e.g., number of employees, number of units, square footage) depending on the type of business. The tax currently generates more than $5 million annually. A number of cities have similar programs in place with comparable fees to Pasadena. However, others namely Santa Monica and Beverly Hills have in place taxes based on the gross receipts of businesses. For example, in Santa Monica a corporate or administrative headquarters, manufacturer or retail business would pay $1.25 for every $1,000 in gross business receipts; a contractor would pay $3 for every $1,000 in gross business receipts and professional services would pay $5 for every $1,000. Santa Monica's annual revenue from this tax is approximately $30.8 million. Staff would not recommend pursuing such a tax as it would place Pasadena at a comparative disadvantage to other cities in the surrounding geographic area in attracting and retaining businesses.

Transient Occupancy Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

The City has a transient occupancy tax (TOT) of 12.11 percent. In addition to the TOT, a Tourism Business Improvement District (TBID) assessment of 2.89 percent is also charged on the same occupancy in any hotel. As such, the City's TOT rate is effectively 15 percent, which places Pasadena at the top end in California. A study completed by CaliforniaCityFinance.com in April 2017, determined that the base 15 percent rate charged by Anaheim is the highest TOT rate in California. Anaheim also has a Tourism Improvement District assessment of 2 percent, making that City's total rate 17 percent. As such, while the City could put before the voters an increase in TOT, it would place Pasadena at the highest end of the tax spectrum and could potentially have a negative effect on hotel occupancy within the City.

Utility User Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

Utility User Tax (UUT) is a percentage tax based on the consumption of the utility. In Pasadena, the current tax rate on telephone usage (including cellular) is 8.28 percent, so the tax paid on a $50 phone bill would be $4.14.

The City's UUT rates vary by utility and are as follows:

Telephone: 8.28%	Gas: 7.90%	Video: 9.40%
Electricity: 7.67%	Water: 7.67%	

The City's utility tax collections have been adversely impacted by various trends in recent years. Cable service technology and platform changes and video tax from cable service has been reduced significantly. This trend is anticipated to continue as more options become available. Water and electricity-based UUT revenue has also been trending downward due to water conservation efforts and more efficient water technologies. As such, an increase in UUT rate may not be the most effective means of raising additional revenue.

Payment In Lieu of Taxes (PILOTs)

Charitable nonprofit organizations, including private universities, nonprofit hospitals, and museums are exempt from property taxation in all 50 states. At the same time, these nonprofits impose a cost on municipalities by consuming public services, such as police protection and roads. Payments in lieu of taxes (PILOTs) are payments made voluntarily by these nonprofits as a substitute for property taxes.

In recent years, municipal revenue pressures have led to heightened interest in PILOTs, and over the last decade they have been used in at least 117 municipalities in at least 18 states. Large cities collecting PILOTs include Baltimore, Boston, Philadelphia, and

Pittsburgh. PILOTs are most appropriate for municipalities that are highly reliant on property tax and have a significant share of total property owned by nonprofits that provide only modest benefits to local residents relative to their tax savings. Any implementation of PILOTs in Pasadena with existing tax-exempt entities would be subject to separate negotiations. Further, it should be recognized that the potential for changes in federal tax law coupled with the financial realities faced by various institutions locally, would likely complicate the pursuit of this potential source of revenue.

Excise Tax

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

An excise tax is generally levied on the business of selling specific goods or services. Most tobacco and alcohol taxes are excise taxes, and the recently approved statewide marijuana taxes approved as part of Proposition 64 are excise taxes. A couple of cities in California also have approved excise taxes on the sale of sugary beverages. In these cases, the tax is a set amount per ounce of sugary beverage sold and the burden to remit the correct amount per volume of beverages sold falls upon the business.

An excise is considered an indirect tax, meaning that the producer or seller who pays the tax to the government is expected to try and recover or shift the tax by raising the price paid by the buyer. These taxes are typically imposed in addition to other taxes such as sales tax. The proceeds generated from an excise tax may be either for general or special purposes, which would determine the voter threshold required.

On February 26, the City Council approved the submission of an ordinance imposing a cannabis business tax to the qualified voters of the City in June 2018. Assuming that at the same election, voters approve land-use regulations to allow a limited number of cannabis businesses in the City it, is estimated that the cannabis business tax would generate between $1.4 million and $2.1 million annually. While this would be a general revenue measure, it is anticipated that roughly the same amount of money will need to be expended by the City annually to address enforcement efforts against illegal cannabis operators, provide public education, and supplement existing safety programs.

Assessment District

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

An assessment district may be created for a variety of different purposes and depending on the type of district, it may encompass operational costs or capital improvement costs. The Tourism Business Improvement District mentioned above in the TOT section is one type of assessment district. Each type of assessment district has a unique methodology for adoption which may include processes such as mail-in ballots or protest elections.

Benefit Assessments are used by local governments to pay the costs of providing fire suppression, flood control and other services to a particular community. These charges are based on the concept of assessing only those properties that directly benefit from the services or improvements financed. Prior to creating a new assessment, a city must generate a detailed professional engineer's report outlining the proposed area, proposed project costs, annual cost to each property, and the benefit formula used to determine each property's share of the cost.

1982 Act Benefit Assessment Districts provide cities with a means to finance the maintenance and operation of public systems such as drainage, flood control, street lighting or public streets and highways. Similar to the Benefit Assessments above, only those properties that benefit from improvements financed, either directly or indirectly through increased property values. This type of district may not be used to issue bonds.

Community Rehabilitation Districts were legalized in 1985 to provide cities with a means to finance the rehabilitation, renovation, repair or restoration of existing public infrastructure. Types of facilities that can be improved include streets, sewer and water pipes, storm drains, sewer and water treatment plants, bridges and overpasses, street lights, public buildings, criminal justice facilities, libraries and park facilities. This type of district cannot be used to pay for maintenance.

In addition to the three districts highlighted above, other types of districts include Street Lighting districts, Abatement Districts, Business Improvement Districts, Mello-Roos Community Facilities Districts, Community Rehabilitation Districts, Maintenance Districts, Vehicle Parking Districts, and 1972 Act Landscape and Lighting Districts. As noted by the titles, these districts are generally formed for very specific and unique purposes.

Transaction Tax (Sales Tax)

Uses: Operating costs or Capital projects
Voter approval threshold: Two-Thirds if for a designated purpose i.e., special tax or simple majority if for general purpose.

The taxes imposed by transaction tax districts are commonly referenced as additional sales tax measures. State law provides that individual jurisdictions (cities) may form one or more transaction tax districts as long as the total tax levy, including the rate of countywide districts, does not exceed 2.0 percent. As discussed above, agencies in Los Angeles County that do not currently have a transaction tax, have the ability to approve a tax measure up to 0.75 percent without the need for special legislation.

Since transaction tax is applied differently than traditional sales tax, the generation of new revenue is not equal to what is currently received with the 1.0 percent Bradley-

Burns sales tax allocation. Generally, a transaction tax generates less than the current sales tax. Based on the City's receipts for fiscal years 2015 and 2016, a local transaction tax of 0.75 percent would potentially generate $21 million during the initial year of implementation. If the City's tax proceeds are utilized for a specific purpose (i.e., a special tax), a two-thirds voter approval is required.

The following table outlines potential revenues obtained during the initial year of implementation based on various transaction tax rates of 1.0 percent or less. Revenues could increase further since businesses often reach full compliance with a new rate during the second year of implementation.

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

In regards to the first category listed above, Autos and Transportation, a concern was raised at the January 29th meeting that imposition of a local Transaction Tax would place local car dealers at a disadvantage as compared to out of city dealers. This is not the case because the sales/transaction tax applied to a purchase of an automobile is based on the County/City where the vehicle is registered. Thus, for example, a resident of Altadena would not pay the local Pasadena Transaction Tax when purchasing a vehicle from a Pasadena based dealership.

Of the potential revenues discussed above, a sales tax is considered preferable for a number of reasons. Unlike the property-related taxes, a sales tax would be paid by all those shopping in Pasadena, not just residents. Each day approximately 110,000 people commute to Pasadena to work, attend school or enjoy the city's many amenities and these visitors would be paying their fair share for using our roads, 911 or other services. Thus, a sales tax would be spread across a large base of consumers, so while a ¾ cent local tax would be expected to generate approximately $21 million per year, to the consumer it would add only 75 cents to every $100 of taxable transaction. Conversely, an increase in the TOT or the advent of a gross receipts business tax would target specific groups, hotel visitors in the case of TOT and local businesses in the case of a business tax. Sales tax has also been attractive to other cities because it is a highly flexible funding mechanism often generating adequate locally-controlled revenue for both service and infrastructure needs. Finally, it is not applied to food purchased as groceries or prescription medication.

Staff has recommended that the City Council ask voters to consider enacting a general purpose ¾ cent local tax to be used to support City services such as police, fire, paramedic services, libraries and other programs as well as invest in aging infrastructure. Separately, the Mayor and staff have also recommended that a separate advisory ballot question be placed in front of the voters asking them whether a portion (1/3 was recommended) should be used to support local public schools and educational programs. These would be separate ballot questions, and the advisory measure would be non-binding on the Council. In the event the Council chose not to proceed with an advisory measure or if the advisory measure were to garner less than 50% support by voters, staff would continue to recommend pursuing a ¾ cent tax for general City purposes as opposed to seeking a lower amount such as ½ cent. The dollar value between ¾ cent and ½ cent tax rates is approximately $7 million per year and given the City's pressing capital investment needs coupled with the potential structural imbalance in the operating budget it would be fiscally imprudent not to do so.

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.

Council direction is critical at this time for a number of reasons. Staff is currently preparing the Fiscal Year 2019 Operating and Capital Budgets. In the event the proposed plan does not proceed, it will impact the decisions necessary to close the current and future anticipated budget gap as well as affect future capital project planning. In order to properly prepare for a November 2018 ballot, a robust public outreach and informational campaign would necessarily need to begin immediately. And finally, as discussed above, given the potential for a future County measure or success of efforts to limit local governments' ability to seek voter approval, November 2018 may, at a practical level, be the City's last opportunity to place a local measure that would maintain quality services and invest in aging infrastructure in front of voters.

If so directed by Council staff will prepare the appropriate materials and return to the City Council no later than the meeting of July 23, 2018, in order to provide adequate time to call the election for 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:

This report highlights the fiscal challenges facing the City in terms of both the Operating and Capital Budgets and outlines a possible approach to addressing them.

Respectfully submitted,

MATTHEW E. HAWKESWORTH
Director of Finance

Approved by:

STEVE MERMELL
City Manager