

## STAFF REPORT

**DATE:** June 10, 2014  
**TO:** City Council  
**FROM:** Gene Rogers, Interim City Manager  
**SUBJECT:** Potential Tax Measure for November 2014 Ballot

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### **Recommendation**

1. Review the information provided in this report and provide direction on which potential ballot measure(s) to study in more detail at the Council study session to be conducted on June 17;
2. Consider a parcel tax that would fully fund the parks maintenance budget and/or a parcel tax that would provide substantial funding for unfunded capital needs, including road maintenance, bicycle paths/trails, and other priority capital projects;
3. If no action is taken to place a tax measure on the November 2014 statewide election ballot, make it a legislative priority to study a general tax measure that would augment the general fund by providing funding to address the city's long term budget deficit, deferred maintenance and unfunded capital needs. Since it would be a general tax, it should be targeted for the June 2016 municipal election ballot.

### **Fiscal Impact**

There is no fiscal impact associated with actions that council may take at this time.

### **Council Goal(s)**

- Fiscal Stability

### **Background and Analysis**

Council requested staff to bring this legislative matter before the body immediately after the state primary/municipal election. The purpose of this report is to provide information about a potential tax measure that Council may decide to place on the November ballot or consider for a subsequent election. A staff report presented to Council last February 11 provided information about two potential tax measures that were under consideration—a sales tax ordinance and a parcel tax ordinance. The full report is attached. After deliberating about the subject, Council decided by unanimous vote to place a ½ cent sales tax increase measure on the ballot for the June 3 state primary election. Technically the measure increased the existing ½ cent sales tax to one cent and extended its expiration to 2020.

The primary election has been concluded and the sales tax ordinance has been approved. The additional sales tax is expected to raise \$3.6 million annually. After several years of enduring significant staff cuts, compensation reductions and organizational restructuring, the city's current general fund budget is temporarily stabilized going into FY2014/15. Long term financial projections, however, foreshadow that the city will continue to struggle with its finances until the day comes when its economic development initiatives are realized and more revenue is produced through growth in the tax base as well as job growth that benefits local businesses. The economic benefit to the budget, however, is more likely to occur several years in the future and revenue growth attributable to economic expansion is not factored into the 5 year financial projection from which this conclusion is drawn.

Though there is a significant spike in revenue from the newly imposed sales tax, the 5 year projection predicts that the current reserve of \$5 million will be virtually eliminated without additional reductions in costs or additional revenues. It would be imprudent to let the reserve draw down below the projected 3.8 million predicted at the conclusion of the FY14/15 budget year. More cost reductions and revenue increases will need to be considered through time. Importantly, it must be acknowledged that there is a growing list of unmet maintenance and capital needs that will require funding from the city's general fund unless or until alternative funding sources can be identified. In response to this situation Council has expressed interest in placing a parcel tax measure on a future ballot, perhaps as soon as the statewide election to be held in November 2014.

#### Parcel Tax (requires 2/3 majority vote)

Currently there is a special voter-approved parcel tax for parks maintenance (parks tax) levied on each parcel in the city. The parcel tax on each residential unit is \$49. Commercial, group living, industrial and day care are taxed on different bases. It raises \$1.4 million annually, which is about 20% of the current Parks operating budget. There is also a parcel tax of \$24 per residential unit which provides funding for the acquisition and maintenance of open space. It raises \$650,000 annually.

Council has not determined the nature of a potential parcel tax. One option previously discussed by Council is to increase the existing parks tax to a higher level. Funding the complete Parks maintenance operating budget of \$6.9 million would require an additional levy of about \$200 per residential parcel. While at first blush that may seem high, in reality the cost to a residential unit is less than \$20 per month; \$16.66 to be exact. Presumably this tax would guarantee that the quality of parks maintenance remains high, it would provide more resources for capital projects, and it would relieve some of the stress on the general fund which can then apply the savings to augment operations where service levels have dipped below standard and to deferred maintenance and other desired capital projects. The ballot measure could also identify specific projects that would receive priority, such as replacement or rehabilitation of playground equipment, bicycle paths, athletic fields and any number of other projects that are related to parks and recreation services. A partial list of identified needs is included in Attachment A.

Another variation that was previously discussed by Council is a parcel tax that would raise funds to be used exclusively for road maintenance and rehabilitation. In addition to routine

maintenance activities undertaken daily, there is a backlog of recommended road repairs and rehabilitation for which there is inadequate funding available.

One option for transportation related capital projects (and perhaps other capital projects for that matter) is to bond for the projects by committing parcel tax receipts to repay the debt associated with the projects, but one implication is that bonded debt would require a long-term commitment, say 30 years, for the parcel tax to remain in place since bond underwriters would need guarantee on the revenue stream. Also it should be emphasized that bonds cannot be issued for routine maintenance. An alternative is to impose the tax and fund the projects in a “pay-as-you-go” manner.

Another option is to consider issuing bonds funded by ad valorem tax. The ad valorem alternative is only available for bond financing and the use of funds is restricted to capital projects only, not maintenance. Once the capital plan funded by the bonds is completed and funded, then the bond measure could automatically expire if desired, or a term limit could be set.

There are other ways for parcel tax receipts to be dedicated, such as public safety or other capital projects not mentioned herein.

#### General Tax (requiring simple majority vote)

There are a several commonly-levied general taxes—taxes that are available for any lawful expenditure—with a simple majority vote threshold that are available as “local” taxes to California local government. The most common are utility users taxes, business taxes, transient occupancy (hotel) taxes, and certain sales taxes. With the apparent passage of its local sales tax measure the city now collects all of the above forms of general taxes except the utility users tax. Utility users taxes are levied as a percentage of the direct cost of the utility service delivered, such as electricity. The tax appears in the monthly billing paid by the customer and the tax is paid to the utility which in turn remits the taxes to the local government that levied the tax. Many California cities levy a utility users tax and it is often a substantial revenue stream for their general fund. Utility users tax is easy to collect and administer, it tracks with inflation, it applies to a broad range of the population (e.g. homeowners, renters, businesses) and it is not as sensitive to economic downturns as the other general taxes. The tax may be levied on electricity, gas, garbage, water, communications, sewer and/or cable television. The 2012 State Controller’s Report identifies 145 California cities that have a utility users tax with rates that range from 1 to 10%, with most ranging between 3 and 7%. The median tax rate is 5%. Of the four Yolo County cities only Winters imposes a utility users tax (at the rate of 9.5%). It is not possible to determine how much revenue would be raised by a utility users tax in Davis since it is not certain what utilities the tax would cover if it is enacted. To give some perspective, however, if the median of 5% was levied on all utilities, the annual income generated is roughly projected to be in the \$3-4 million range.

To balance the budget without drawing on reserves is projected to require about \$1 million per year. In addition, as noted, there are significant unfunded maintenance, rehabilitation and other capital projects for which there is no available funding source. With the city’s annual general fund needs being several million dollars, increases in the business tax and transient occupancy

wouldn't generate enough revenue to do anything more than put a dent into the problem. A sales tax increase of ¼ cent would produce about \$1.8 million annually. The cumulative sales tax percentage, however, may be reaching a threshold where it is perceived to be on the high side.

### Which Taxes and Approaches Should Be Studied and Considered Now?

The information in this report is provided as the starting point for the next step of Council's quest to secure adequate funding to sustain city operations and capital funding needs. From staff's perspective at least two basic approaches should be studied further—parcel tax and a general tax. Insofar as a general tax is limited as to when it can go on the ballot, it should be considered as an option at a later time, if desired.

As it goes to the parcel tax, there are two basic variations of parcel taxes that have been identified. One provides a funding source that would provide funding to cover all or a significant portion of the current operating budget for parks maintenance. A second option provides a funding source for identified capital priorities, most notably road maintenance and rehabilitation. A third option could be one that focuses on unmet deferred maintenance needs, rehabilitation of certain types of facilities and construction of new capital projects. Finally, another conceivable direction is to consider a bond to fast-track deferred maintenance, rehabilitation and capital projects, funded by a parcel tax.

### How Much?

Regardless of which path may be followed, one of the key decision factors is the amount or rate of the tax levy. This is of course dependent upon the identified need and the practicality of the amount or rate to be imposed.

### How Long?

The just-enacted ½ cent sales tax ordinance specifies a sunset date in 2020. It is a judgment call as to whether that is helpful in making the case for the need for the tax. From an operational standpoint tax elections have unintended consequences including inability to plan on future revenue streams for capital items and the disruption of sometimes divisive elections.

### Timing

As a general rule, special tax elections can be conducted at any time and general tax elections can be conducted only at time at which there are municipal elections (except in cases where there is a fiscal emergency and the body unanimously declares it). Parcel taxes, with their 2/3 majority vote standard, are considered special elections. Utility users taxes are almost always designated as general taxes. Therefore placing a utility users tax measure or any other general tax measure on any ballot other than the June 2016 municipal election would require activation of the emergency provision of Proposition 218(?)

### Inflationary Increases

It is a desirable feature to include some allowance for inflationary increases in tax measures since otherwise the value of the revenue declines significantly over the years. Many taxes, however, have inflation adjustments automatically included in the sense the revenues are sensitive to change in costs since the taxes are based on a percentage, not a flat fee. Such is the case with ad valorem tax, sales tax and utility users tax. For a parcel tax, which pays for operations, either the standard 2% formula used for statewide property tax or some other common inflation index would work. The 2% may be perceived as more acceptable since it is what is used for property taxes. For capital-oriented taxes, such as for bonds, a construction-related index might be appropriate.

### Advisory Measure for a General Tax

If a general tax is placed upon a ballot, in some cases a companion measure advising the Council on preferred use of the funds is placed on the same ballot. In any case, however, Council must maintain its discretion on the allocation of funds raised by the tax measure to maintain its status as a general tax.

### Schedule

The next scheduled meeting is a Council study session to be held on Tuesday, June 17, at 5pm. The purpose of the meeting is to provide an opportunity for Council to study this matter in more depth and provide staff with more direction about what is needed to reach a final decision.

Assuming Council decides to continue to move forward with a measure aimed at the November 2014 election, this item will be scheduled for Council meeting of July 1. The last date possible for Council approve what is required to place a tax measure on the November ballot is July 15.

### Attachments

1. Potential Capital Projects supported by New Revenue Measure
2. February 11 Staff Report on Ballot Measures