

STAFF REPORT

DATE: June 4, 2024

TO: City Council

FROM: Mike Webb, City Manager
Kelly Stachowicz, Assistant City Manager
Revenue Subcommittee (Gloria Partida, Bapu Vaitla)

SUBJECT: Proposed Revenue Measure – November 2024

Recommendation

1. Receive City Manager's State of the City Overview and discuss options to increase revenue to the General Fund.
2. Direct staff to return on June 18 with necessary documents to place a ballot measure on the November 2024 ballot to increase the local sales tax by 1%.

Fiscal Impact

Sales tax revenue fluctuates annually, but the current revenue generated by the local 1% sales tax is approximately \$11 million in General Fund dollars to provide City services and programs (e.g. fire, police, parks, roads and bike paths paving, infrastructure maintenance, affordable housing/social services, general government services, etc.). An additional 1% local sales tax is expected to generate between \$10 and \$11 million annually to offset General Fund expenditures, pay for additional services and programs, and rebuild the General Fund reserve to standard, approved levels. Other revenue options and their approximate revenue generation are included in the body of this report. Where the Bradley Burns sales tax is shared amongst the city, state, County, and other agencies, 100% of a local Davis-specific sales tax stays local.

Council Goal(s)

This discussion is directly related to the Council Goal of Achieving Fiscal Resilience but ultimately touches all Council Goals.

Commission Input

This item is coming directly to the City Council.

Background and Analysis

Over a year ago, on April 4, 2023, the City Council discussed the potential need for a general fund revenue measure in November 2024. The Council reviewed various options for revenue measures, stated a unanimous need for a revenue measure as a priority in November of 2024, and directed staff to return to the City Council with additional information. The Council Subcommittee has continued to work with staff over the past year to discuss options. The link to the 2023 staff report is [here](#).

Defining Need for Additional Revenue

The City Council has long wrestled with balancing the costs of required and desired programs and services, necessary infrastructure, growth and development to suit the interests of the community, and revenue to pay for these programs, services and infrastructure. This balancing act was the genesis of Council discussion in the spring of 2023, as the City was still rebounding from the COVID-19 pandemic and costs for goods and services were increasing quickly.

As noted then, the City continues to act as a strong fiduciary with public funds, endeavoring to stretch every dollar. The City has significantly stepped up grant efforts the last five years, to extend City and outside funding to offset costs to implement Council priorities; partners where possible with other jurisdictions to leverage resources; has recently hired an Economic Development Director to work with the existing business community and attract new businesses to Davis to expand the tax base; and has kept staffing numbers in line with similar size jurisdictions, although the level and type of service expected in Davis is often higher than comparable size communities.

However, costs continue to increase in order to maintain or implement expected service levels. Post-pandemic construction costs have repeatedly exceeded original estimates, with increases across California growing at a rate of 9% year over year, making it increasingly difficult for the City, through no fault of its own, to budget for and successfully bid capital improvement projects. Upon the conclusion of a citywide total compensation study in 2023, the City Council brought all positions up to the market median for total compensation, which is critical for employee recruitment and retention but which also impacts the General Fund. Utility costs, specifically gas and electric costs through PG&E have increased to the tune of \$1 million dollars in the current budget year, a cost increase beyond the City's control and with no increase in service delivery. The City has additional projects it would like to complete, including urban forestry, climate action, affordable housing and social services, and infrastructure (both transportation and facilities).

The proposed Mid-Cycle Budget Update for fiscal year 2024/25 notes that general fund revenues are, in aggregate, tracking mostly as expected but expenditures have increased beyond the original budget assumptions, resulting in a lower General Fund available balance. This structural deficit ultimately requires additional revenue, reductions in expenditures, or a combination of both. This is not unexpected. In the original long range forecast provided last year in the biennial budget for FY23-25, the fund balance was expected to decline starting in FY25 and continue to decline until FY33, before recovering due primarily to decreased pension obligations, as more of the City's workforce will be covered under PEPR, the statewide reformed retirement system.

For the 2024/25 Fiscal Year, staff has presented a budget with a General Fund reserve of 7.5%, half of the target level of 15%, along with over \$3.5 million in General Fund deferrals or one-time reductions. These reductions are a short-term bridge, but are not

viable in the longer term. Additional details about the proposed Mid-Cycle Budget Update can be found elsewhere in this agenda or in the May 21 staff report introducing the budget, which can be found [here](#).

Options

Local governments in California have limited mechanisms to generate revenue beyond funding that funnels through the State and/or County for costs associated with programs, services, infrastructure, and more. The amount of revenue locally is based on the size and type of tax base, as well as the types of taxes in place at the local level. Most common revenue options include increasing the revenue base through growth (which takes both time and community support), a parcel tax, utility users' tax, transactions and use (sales) tax, and/or transient occupancy tax. The table on the next page summarizes potential revenue generation from the most typical types of revenue measures.

Revenue Type	Voter Threshold to Pass and Election Dates	Generate \$1,000,000+	Generate \$5,000,000+	Generate \$10,000,000+	Additional Information
Parcel Tax	2/3 majority Can be at special or general municipal election	\$35/unit	\$177/unit	\$354/unit	Approx. \$28,200 per dollar of tax
Utility User Tax	Simple Majority, if funds unrestricted	1% across all utilities	4.5% across all utilities	9% across all utilities	Phones, gas, electric, water, sewer, solid waste Avg rate is 5%, but ranges 1% to 11%
Transaction and Use (Sales) Tax	If a general tax, must be at general municipal election	0.125% increase (8.375% total tax)	0.5% increase (8.75% total tax)	1% increase (9.25% total tax)	Can increase by 0.125% up to 1% maximum. Each 0.125% is approx. \$1.375m
Transient Occupancy Tax		4% increase (16% total TOT)	10% increase (22% total TOT)	32% increase (44% total TOT)	1% is approx. \$230,000. Current rate 12%

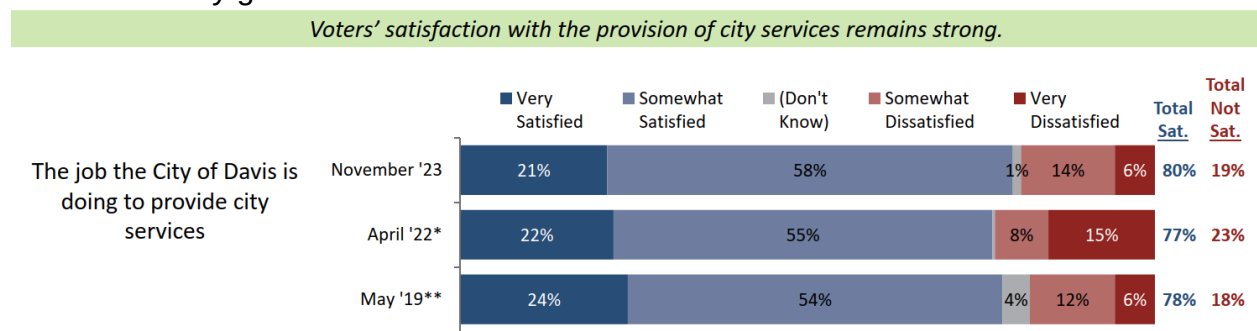
Revenue Uses

If the City Council (and ultimately the voters) approve a general tax, then revenues may be used for any general government purpose. The first priority would be to ensure that existing programs and services continue. Second priority includes shoring up the General Fund reserve and funding deferred capital projects/equipment replacement/liabilities. The third priority is to allocate funds to new programs/services and/or enhance existing services based on Council priorities. A small reserve makes it challenging to respond quickly to unexpected emergencies or needs. Assuming typical inflationary growth, both in revenues and expenditures, and no other major changes in spending levels, the reserve could be restored to 15% within two fiscal years. Or Council could choose to restore the reserve more slowly, so that a greater proportion of any new revenue funded other priorities.

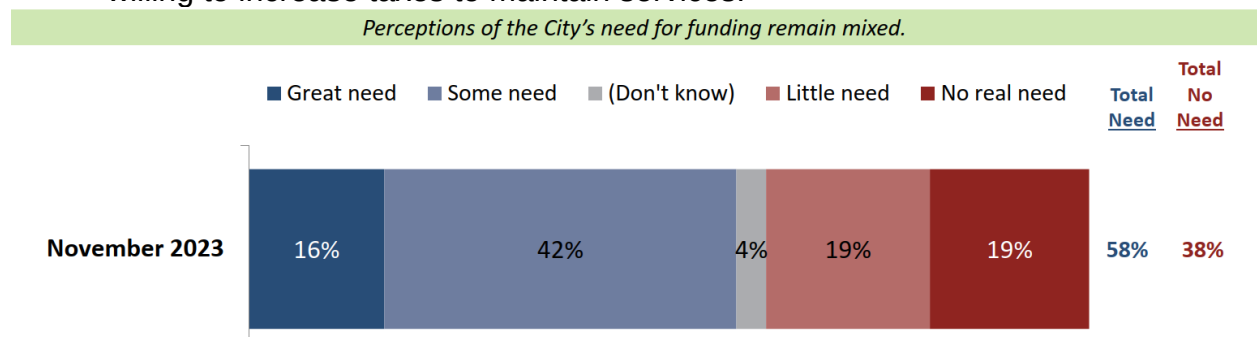
Community Survey

In November of 2023, the City completed a citywide community survey, conducted by EMC Research. The survey included 400 interviews of likely voters (email, text-to-web, and telephone), with an overall margin of error of +/-4.9%. Key findings included the following:

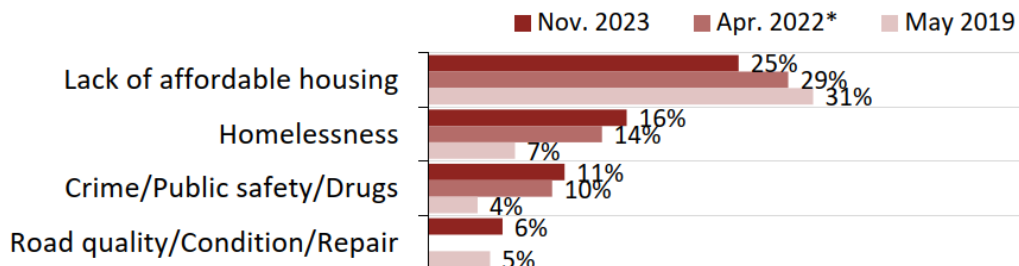
- Davis voters are optimistic about the direction of the city and most are satisfied with City government.



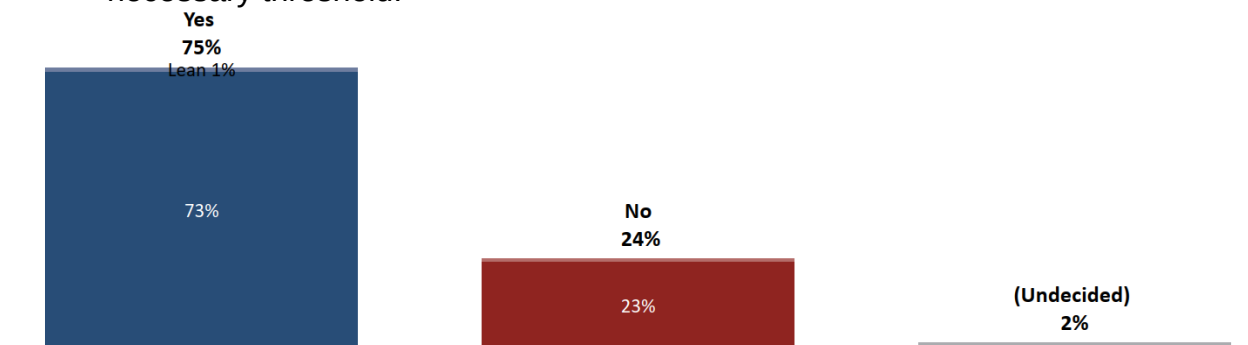
- A majority of voters recognize the City's need for additional funding and are willing to increase taxes to maintain services.



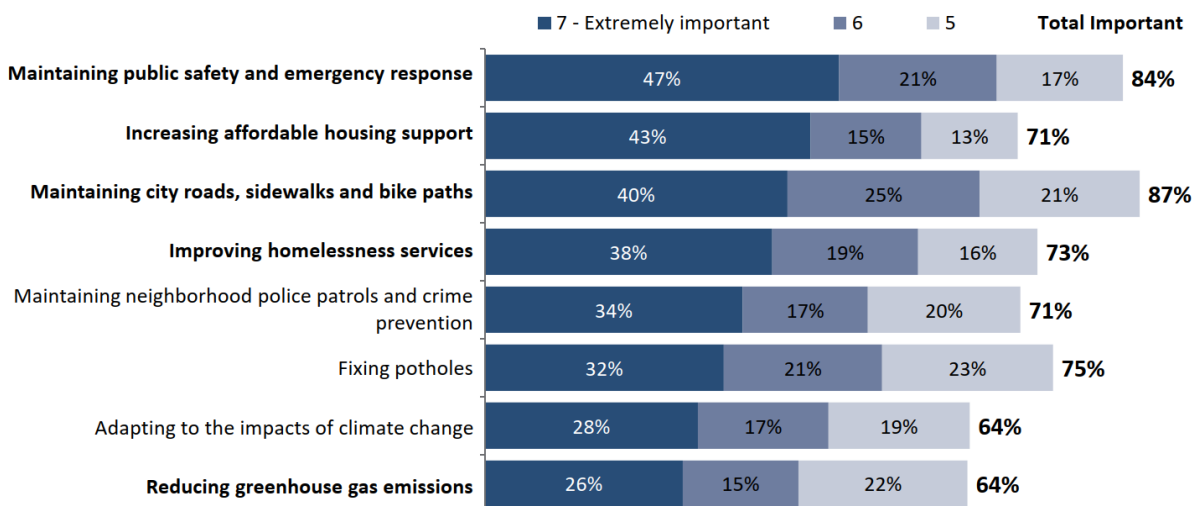
- Affordable housing, homelessness, and crime/public safety are top-of-mind issues for voters as the most important problems facing the community.



- As of the time of the survey, support for a potential measure was above the necessary threshold.



- Maintaining public safety response, roads and bike paths are top tier priorities for voters



Apprehension about a possible sales tax ballot measure included concern that an increase would be too high and make Davis uncompetitive with neighboring jurisdictions. However, other communities in the region have sales tax amounts comparable to Davis, and some are also planning on sale tax measures in November. West Sacramento is at 8.25% and recently took action to place a ballot measure in November to increase that by 1%. Woodland is at 8% and is discussing a sales tax increase for November. Folsom, through a citizens' initiative will be putting a sales tax increase measure on the ballot. Most Bay Area communities are already over 9%.

Others were concerned that a sales tax is regressive. Some of these fears were alleviated once it was stated that essential goods like groceries and medications are not subject to a sales tax.

Another fear was that a general tax cannot by law specify how the funds will be spent. However, the City also by law and by practice has many safeguards in place to ensure funds are spent appropriately and efficiently.

Ballot Measure Language

The City currently has a local transaction and use tax of 1%, and has the ability to increase the tax by another 1% (or any increment of 0.125% up to 1%). The current 1% was last reauthorized in March of 2020 and remains in place until repealed or changed by the voters.

Staff proposes the Council direct staff to prepare an ordinance and accompanying resolution to increase the existing sales tax from 1% to 2%, for a total sales tax rate of 9.25%. This proposed general tax is estimated to generate approximately \$11 million initially and would remain in place until repealed or changed by the voters.

Next Steps

If the City Council concurs with the staff and subcommittee recommendation to place a general sales tax measure on the November 2024 ballot to increase sales tax by 1%, then Council should direct staff and the City Attorney to return at the June 18th Council meeting with the documents necessary to place the item on the November 2024 ballot. If approved on June 18, the City Clerk will provide the information to the County, to include as part of Yolo County's consolidated election. The County requires the information by June 18, or as soon thereafter as possible, in order to include the item on the Board of Supervisors' agenda. Should a measure be placed on the ballot and pass, the City will not begin receiving revenue until approximately June 2025.

While indirectly related, staff is also watching two constitutional amendments on the statewide ballot for November that affect local control. ACA1, if approved, would lower the 55% voter-approval threshold for public infrastructure and affordable housing special taxes and bonds. School districts already have this ability and extending it to other local jurisdictions further empowers local voters. ACA13 would require future ballot measures that increase voter approval requirements to also pass by the same threshold and preserve the right of local governments to place advisory questions on the ballot. Staff is not making a recommendation regarding a companion advisory measure, but it is something the Council may wish to consider.