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20-41 **Agenda Date: 2/11/2020**

REPORT TO COUNCIL

SUBJECT
Discussion of, and Possible Direction on, Revenue Measures for the November 2020 Ballot [Council Pillar: Promote and Enhance Economic and Housing Development]

BACKGROUND
For cities, revenue to cover services is primarily derived from two sources, taxes and fees for services. The City is in process of evaluating revenue options to address unmet capital infrastructure and future ongoing deficits. Below is a summary of these efforts over the past two years.

In May 2018, the City Council discussed and considered five revenue opportunities including: 1) an increase in the Transient Occupancy (TOT) rate, 2) an increase in the Documentary Transfer Tax, 3) Establishment of a Utility Users Tax (UUT), 4) Establishment of a Cannabis Tax, and 5) Establishment of an Infrastructure Parcel Tax. Council moved forward with a Cannabis Tax option for the November 2018 ballot.

In July 2018, the City Council took action to place a Cannabis Business Tax Measure on the November 2018 ballot. Measure M, the Santa Clara Marijuana Business Tax, was approved by the voters with a 76.68% approval rating. Since then, staff has been evaluating the implementation of similar programs throughout the state and will be providing recommendations to the City Council in a separate report on February 11, 2020.

In January 2019, as part of the City Council's Operational and Strategic Priority Setting Session, staff presented the Ten-Year Financial Forecast for the City's General Fund. This forecast, based on assumptions and known risks at that time, projected deficits of approximately $1.6 million for FY 2021/22 and $0.5 million for FY 2022/23 for a total of $2.1 million. In addition, the forecast showed a narrow surplus margin sensitive to changes in the economy or other changes in known risk factors (e.g. pensions, labor negotiations, etc). At that time, Council provided direction to the City Manager to continue working on two revenue strategy options - increasing the TOT and establishing a UUT.

In May 2019, staff presented to the City Council the first phase of a three-phased cost recovery study on the City's existing fee structure. The purpose of this study was to determine how the City's fees compared to other jurisdictions and to provide data to evaluate the impact of the current level of subsidies on the General Fund. This evaluation indicated that the City is subsidizing the cost of services in an amount of approximately $22 million. In an effort to close the gap between fees and cost for services, adjustments to Phase 1 fees were approved by the City Council on July 16, 2019. These fees included routine non-development fees including some new and deleted fees. Phase 2 fees, which included development fees and non-development fire fees, were presented to the City Council in a study session on October 22, 2019 and approved on November 19, 2019. The remaining Phase 3 items from this study were presented as part of individual fee workplans for Council approval. As a result of this review, incremental progress has been made to improve the City's cost recovery rate, freeing up General Fund dollars that can be used to support the City's other unmet needs.

On November 5, 2019, staff presented additional information on a potential TOT measure, an update on UUT exploration, and two potential measures (a parcel tax or general obligation bond) to fund infrastructure needs. The City Council provided feedback and requested a study session to better understand the pros and cons of an infrastructure parcel tax versus a general obligation bond.

The purpose of this report is to provide the Council with the requested study session information related to potential infrastructure revenue measures as well as other revenue opportunities the Council may also wish to consider in the future.

DISCUSSION

During the January 2020 City Council Priority Setting Retreat, staff presented an update to the Ten-Year Financial Forecast for the City's General Fund. As displayed in the table below, the deficit has grown by $11 million ongoing over the previous forecast. Over the next four years, the deficit is projected to total $13.3 million ongoing.

Table 1 - General Fund Ten-Year Financial Forecast

FY 2021-2031 General Fund Ten-Year Financial Forecast ($ in millions)											
	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Net Operating Margin	($4.8)	($3.0)	($4.9)	($0.6)	$0.1	$2.3	$2.7	$2.2	$1.4	$2.9	$3.5
% of Expenses	(2.0%)	(1.1%)	(1.7%)	(0.2%)	0.0%	0.7%	0.8%	0.7%	0.4%	0.8%	1.0%

Some of the key changes contributing to this decline include a decrease in Stadium Authority revenue ($2.7 million), labor and other expenditures beyond assumptions ($4.3 million), CalPERS actuarial change ($0.7 million) and other further refinement of major revenue projections ($3.7 million).

In addition to these key changes, the City's infrastructure continues to age, and departments have identified approximately $190 million in capital project needs over the next five years. However, there is only $27.5 million currently available in the Capital Budget to fund those projects. It is important to note that of this $27.5 million, approximately $10 million is already earmarked to fund required ADA improvements.

As shown in the ten-year financial forecast, the City faces ongoing deficits totaling $13.3 million over the next four years. This forecast assumes a mild slow down and additional risk factors that have begun to materialize. Strategically, it will be important for the City to close this gap with a combined approach of new revenues, improving the level of cost recovery of our service fees, and evaluating opportunities to reduce costs through changes in services delivery.

The following section provides information on the three revenue measure options previously discussed by Council for consideration on the November 2020 ballot - an increase in the TOT, a General Obligation Bond and a Parcel Tax.

Transient Occupancy Tax

A Transient Occupancy Tax commonly known as a "hotel tax", is charged by the City to guests of hotels and short-term rentals within the City. In FY 2018/19, TOT revenue collections totaled $22.5 million or 9.1% of the City's General Fund revenue. This revenue is used for general local governmental purposes such as Police, Fire, Public Works, Parks and Recreation, and Libraries. During the November 2018 elections, ballot measures increasing the TOT rates passed in the cities of Los Altos (11% to 14%, phased over three years), Sunnyvale (10.5% to 12.5%), Milpitas (10.0% to 14.0%) and Palo Alto (14.0% to 15.5%). The City of Santa Clara's current TOT rate is 9.5% which is one of the lowest in the County, as shown in Table 2.

Table 2 - TOT by Santa Clara County Cities

Transient Occupancy Tax by City

City	Rate
Gilroy	9.0%
Santa Clara (w/o CFD)	**9.5%**
Saratoga	10.0%
Fremont	10.0%
Mountain View	10.0%
San Jose	10.0%
Morgan Hill	11.0%
Los Altos	12.0%
Campbell	12.0%
Cupertino	12.0%
Los Gatos	12.0%
Sunnyvale	12.5%
Milpitas	14.0%
Palo Alto	15.5%

In addition to the current TOT rate, in May 2010, the City Council approved the formation of a Community Facilities District (CFD) as part of the Levi's Stadium project. The CFD includes hotel properties in the vicinity of Levi's Stadium. These hotel property owners voted unanimously to place a special tax on hotel room nights equivalent to a 2% TOT rate. There are currently eleven hotels that pay CFD special tax. This special tax is pledged to finance portions of the publicly owned infrastructure for the stadium project. With the addition of the CFD, hotel guests currently pay 11.5% at the eleven hotels located around the Stadium and Convention Center, as noted in Table 3 for comparison purposes.

The CFD exists to pay the debt infrastructure improvements related to Levi's Stadium, which was issued at approximately $35 million. This debt is secured by and payable solely from the special taxes levied on the hotel properties within the CFD and does not represent an obligation or debt of the City or the City's General Fund. *Section 10.3 - TOT Credit* in the Disposition and Development Agreement (DDA) states in part that the City may increase the TOT rate from time to time. However, if the City increases the TOT by 1%, the funding amount that would go to the Stadium Authority, once the debt has been fully paid, would be reduced proportionately.

The City currently has 37 businesses that pay TOT, including online rentals. The majority of these businesses charge hotel guests the 9.5% TOT rate. However, the eleven hotels located in the CFD area provide 75% of the City's overall TOT revenue.

It is important to note that TOT is a volatile revenue source because it is strongly correlated with the state of the economy. For example, in the last recession this revenue source decreased by 28% or $3.2 million in 2009/10 when compared to the peak of $11.3 million in 2007/08. In FY 2018/19, this revenue rose to $22.5 million (normalizing for accruals). While increasing the TOT rate is a viable option, a recession in the future years could substantially reduce this anticipated revenue.

Additionally, it should be noted that the consideration to change the Tourism Improvement District fee from $1 per occupied room night to a percentage of the gross room revenue has not yet been factored in. This discussion is included in a separate report scheduled for the February 11, 2020 Council meeting.

General Obligation Bond

A General Obligation (GO) bond is a common form of long-term capital project financing. This type of bond can only be used to fund a "municipal improvement," which is most often an acquisition or improvement of real property. The issuance of these bonds requires a two-thirds supermajority vote of the registered voters pursuant to Article XIIIC of the State Constitution. GO bonds are secured by levying ad valorem property taxes in an amount deemed necessary to pay the debt service. This amount is in addition to the 1% general ad valorem property tax.

GO bonds are generally based on assessed values (AV) and can be issued for various lengths of time, with the most common being 30-year bonds. As provided by the County of Santa Clara for FY 2019/20, the taxable assessed values for secured and unsecured property are $38.5 billion and $7.6 billion, respectively. Based on this information, Table 3 below shows the potential annual debt service payments for $100 million, $200 million, $300 million and $400 million bond issuances, over a 30 year-period at an interest rate of 5%. It should be noted that these assumptions are used for illustration purposes only. Actual bonds would be issued competitively to ensure the best market rates are obtained for potential future bonds. The table also details the impact to property owners per bond issuance amount. For example, in Option 1, a $100 million bond issuance would result in an additional $142 to the property owner's tax bill per $1.0 million in AV, annually. With each option increase, the tax bill increases by an additional $141 per year for both secured and unsecured property.

Table 3 - GO Bond Issuance Comparison

	Bond Issuance Amount	Interest (5%)	Total Debt	Secured & Unsecured - Rate / $ 1 M	Estimated Annual Debt Service Payment
Option 1	$ 100 M	$ 95.2 M	**$ 195.2 M**	$ 142	**$ 6.6 M**
Option 2	$ 200 M	$ 190.3 M	**$ 390.3 M**	$ 283	**$ 13.1 M**
Option 3	$ 300 M	$ 285.5 M	**$ 585.5 M**	$ 424	**$ 19.6 M**
Option 4	$ 400 M	$ 380.6 M	**$ 780.6 M**	$ 565	**$ 26.1 M**

Infrastructure Parcel Tax

A parcel tax is levied on a property owner's property tax bill and can be a fixed amount or based on a factor, such as the building's or land's square footage. This tax can also be for a predetermined period of time or can be permanent. Parcel taxes can be used for operating and program costs in addition to municipal improvements. Per State law, tax proceeds cannot be used to directly pay for debt service. If the City wanted to issue bonds to pay for infrastructure improvements paid for by parcel tax proceeds, there are two options. First, the City could issue lease revenue or certificates of participation bonds paid by the General Fund. Parcel tax proceeds could be used to reimburse the General Fund for those payments. Second, a Special Tax Ordinance could be passed by the City prior to the ballot to use parcel taxes to pay directly for debt service. Approval of this special tax requires a two-thirds supermajority vote.

The most common type of parcel tax is the fixed parcel tax. This tax requires owners of smaller properties to pay the same amount as owners of larger properties. A fixed parcel tax may create fairness issues as owners of lower valued property would pay the same as an owner of a higher valued property (e.g. single-family home and a larger commercial business). Other square footage-based measures based on land size or building size can be considered. It should be noted, as the type of measure increases in complexity, it may be confusing to voters.

Based on the Santa Clara County Tax Assessor 2019/20 Combined Tax Rolls, the total number of taxable parcels is 28,888. The taxable parcels are separated out by land use categories: residential (27,240), commercial (756) and industrial (892). Generally, properties that are exempt from property tax are also exempt from parcel tax.

The City worked with its financial advisor, KNN Public Finance, to analyze the expected tax amount per median parcel if it was based on a flat tax rate, the land size, and the building size. Based on the 2019/20 Santa Clara Secured Property Roll, the median parcel size for land area is 5,850 square feet, while the median parcel size for building area is 1,465 square feet. Table 4 below illustrates the expected cost for each type of parcel tax and the estimated revenue that could be generated by each.

Table 4 - Estimated Tax Per Median Parcel

	Parcel Tax Revenue	Fixed Rate	Rate Based on Land Size (per 1,000 sq. ft)	Rate Based on Building Size (per 1,000 sq. ft)
Option 1	$ 6.5 M	$225	$23	$61
Option 2	$ 13.0 M	$450	$46	$122
Option 3	$ 19.5 M	$675	$70	$183
Option 4	$ 26.0 M	$900	$93	$245

GO Bond and Parcel Tax Comparison

Table 5 below compares several characteristics of a GO bond and infrastructure parcel tax, including the cost to the residents as well as the eligibility of use of funds.

Table 5 - GO Bond/Infrastructure Parcel Tax Comparison

	GO Bond	**Parcel Tax**
Revenue	Lump Sum Up Front	Ongoing or Fixed Term
Term	One-time funding	Can be a permanent tax or approved for a specified period of time
Bonding/Payment of Debt Service	Direct	General Fund Reimbursement or Special Tax Ordinance
Expenditure Use	Capital infrastructure	Capital infrastructure and programs and operations
Approval Needed	2/3rd supermajority	2/3rd supermajority

One consideration between both methods of funding and how the tax is applied is equity and the burden of who would pay for the tax. Based on data from the County of Santa Clara, Table 6 below shows an estimated spread of how the taxes would be collected by property type.

Table 6 - Comparison of Tax by Property Type

Property Type	**GO Bond Assessed Value**	**Fixed Parcel Tax**	**Land Size Based Parcel Tax**	**Building Size Based Parcel Tax**
Residential	58%	94%	57%	53%
Commercial	23%	3%	17%	20%
Industrial	19%	3%	26%	27%

Other Revenue Opportunities

Given the large outstanding backlog of capital infrastructure, it is likely that additional revenue measures will need to be pursued beyond the November 2020 ballot. Other types of revenue measures that have been used successfully in other jurisdictions include: modernization of the Business License Tax, adjustments to the Documentary Transfer Tax, and application of new Utility User Taxes. Should Council wish to explore these options, additional study and strategic planning would be required to better understanding the viability of each option.

Next Steps

The City is currently in negotiations with a consultant firm to assist with voter education and polling services related to the successful passage of revenue measures on the November 2020 Ballot. Based on Council's direction as to the preferred revenue strategy or strategies, the consultant's scope of work will include, but not be limited to:1) working with City staff to identify unfunded needs; 2) validating funding priorities through community engagement, voter education and polling; 3) drafting appropriate ballot measure language; and 4) ensuring compliance with election requirements. The following is a general timeline of the steps needed to meet the November 2020 ballot:

- February 2020 - Execute contract for polling and outreach
- March-June 2020 - Polling/outreach to determine community interest/priorities
- May-July 2020 - Evaluate options and make final determination
- July 14, 2020 - Submit final ballot measure for November 2020 ballot

FISCAL IMPACT

There is no impact from the discussion of this report. Funding to provide outreach and community engagement on the ballot measures was included in the FY 2019/20 Adopted Operating Budget. Actual November 2020 ballot costs will vary based on the number of ballot measures registered at the County and a base amount is included in the FY 2020/21 Adopted Budget. Budget amendments, if necessary, for ballot measure costs with the County will be recommended separately for Council consideration. If approved, revenue ballot measures will bring additional funding for public services and capital infrastructure.

COORDINATION

This report has been coordinated with the City Attorney's Office and City Manager's Office.

ENVIRONMENTAL REVIEW

The action being considered does not constitute a "project" within the meaning of the California Environmental Quality Act ("CEQA") pursuant to CEQA Guidelines section 15378(b)(4) in that it is a fiscal activity that does not involve any commitment to any specific project which may result in a potential significant impact on the environment

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall Council Chambers. A complete agenda packet is available on the City's website and in the City Clerk's Office at least 72 hours prior to a Regular Meeting and 24 hours prior to a Special Meeting. A hard copy of any agenda report may be requested by contacting the City Clerk's Office at (408) 615-2220, email clerk@santaclaraca.gov <mailto:clerk@santaclaraca.gov> or at the public information desk at any City of Santa Clara public library.

RECOMMENDATION

Discussion of, and Possible Direction on Revenue Measures for the November 2020 Ballot.

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