



Agenda Report

19-1104

Agenda Date: 11/5/2019

REPORT TO COUNCIL

SUBJECT

Discussion of, and Possible Direction On, Review of Potential General Fund Revenue Opportunities for the November 2020 Ballot; Authorize the City Manager to Negotiate and Execute Contracts for Community Research and Outreach

EXECUTIVE SUMMARY

The purpose of this presentation is to inform the City Council (Council) of staff's efforts to advance the City's priorities to stabilize our fiscal outlook in order to preserve service and staffing levels, generate more revenue to meet expenditure growth demands, and develop strategies for unfunded needs/projects.

During the January/February 2019 Council Goal Setting Session, the City Manager presented the City's Ten-Year Financial Forecast which showed ongoing deficits in years three and four. At the priority setting session, the Council gave direction for staff to return with an analysis of revenue options for Transient Occupancy and Utility Users Tax revenues.

Per Council direction, staff has worked on revenue options for Council consideration. While Council gave staff direction to also explore the establishment of a Utility User Tax (UUT), staff does not recommend creation of a UUT at this time, as discussed further in this report. This report considers the following revenue opportunities:

1. Increase in the Transient Occupancy Tax (TOT) rate,
2. Issue a General Obligation Bond, and
3. Establish an Infrastructure Parcel Tax.

Consistent with past discussions, revenue generating measures need to be evaluated with respect to what voters will likely support and it is generally recommended that measures be limited to two per ballot. City Council input regarding these three revenue opportunities will help staff determine which measures should move forward for further analysis and research for the November 2020 General Election ballot. While these items are viable, it is understood that each requires significant community and stakeholder engagement which, for some, may take more time.

The results of the community research and outreach will be presented to Council in the May/June 2020 timeframe, with final Council action on a recommended ballot measure in July 2020 in order to place the measure on the November 2020 ballot.

BACKGROUND

In May 2018, the City Council discussed and considered five revenue opportunities including: 1) Increase the Transient Occupancy (TOT) rate, 2) Increase 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.

In July 2018, the City Council approved a November 2018 Ballot Measure for a Cannabis Business Tax. In November 2018, the residents of Santa Clara passed Measure M: Santa Clara Marijuana Business Tax with a 76.68% approval percentage. The development of a Cannabis Regulatory Program is underway and will be before the City Council before the end of calendar year 2019.

In January/February 2019, at the City Council Operational and Strategic Priority Setting Session, staff revised and presented the Ten-Year Financial Forecast for the City's General Fund. The forecast presented shows a modest surplus of \$1.1 million in FY 2019/20 and \$0.1 million in FY 2020/21. However, the forecast shows that a deficit in FY 2021/22 and FY 2022/23 is forecasted based on assumptions and risks presented at that time. The forecast also shows a narrow surplus margin, which can change quickly with an economic slowdown or other known risk factors.

FY 2020-2030 General Fund Ten-Year Financial Forecast Net Operating Margin- Ongoing Surplus/(Deficit) (\$ in millions)										
2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
\$1.1m	\$0.1m	(\$1.6m)	(\$0.5m)	\$0.7m	\$1.0m	\$1.5m	\$2.6m	\$2.9m	\$1.7m	\$2.6m
As a percentage of projected operating expenditures										
0.4%	0.0%	(0.6%)	(0.2%)	0.3%	0.3%	0.5%	0.8%	0.9%	0.5%	0.8%

Some of the risk factors not reflected in the forecast are known factors that we have identified as risks, but the list is not an exhaustive set of potential risks:

- Decrease in Stadium Authority revenue (approximately \$2.7 million unrealized revenue to the General Fund)
- Labor negotiations and expenditures beyond assumptions
- CalPERS actuarial changes or any CalPERS reform actions
- Downturn in economy / decline in revenues
- Infrastructure operating budget impacts
- State and federal legislative changes
- Further refinement of major tax revenue projections (example: commercial cannabis deferred implementation, \$600,000 - \$2.4 million potential loss in projected anticipated revenue)
- Revenue and staffing impacts of development projects

While staff has identified the potential fiscal impact of two risk factors, other financial impacts are still unknown and to be determined.

As part of the City Council Operational and Strategic Priority Setting Session, the Council also provided direction to the City Manager to continue work on two revenue strategy options, increasing the TOT and establishing a UUT.

Additionally, as part of the continuing effort to advance the City's priorities to stabilize our fiscal outlook, staff also explored revenue opportunities through a comprehensive review of user fees. In May 2019, the Council began the first phase of a three-phased approach to evaluate fees where the

City is under-collecting the cost of providing services in order to minimize or eliminate the use of limited general tax revenues. This funding gap totaled over \$22 million, therefore, services are being subsidized by other City revenue sources. The Council continued the review of phase two during a study session on October 22, 2019 with approval of changes to the user fees scheduled for November 19, 2019. The last phase of this study is scheduled for December 17, 2019 and the Council's actions to increase cost-recovery of user fees are directly related to freeing up funds available to invest in city services.

The purpose of this report is to provide the Council with an analysis of potential revenue strategies to preserve current service and staffing levels as well as to identify opportunities to support currently unfunded priority projects and anticipated future growth in demands for services.

DISCUSSION

As shown in the ten-year financial forecast, the City will face ongoing deficits in years three and four of the forecast period. While this forecast assumes a mild recession, additional risk factors have been identified since the development of the forecast which add considerable risk to the financial outlook. For example, the performance rent related to Non-NFL Stadium events is anticipated to be close to zero in the near future. In addition, recently approved labor agreements were modestly above the forecast assumptions.

While a forecast update with revised revenue and expenditure assumptions will be brought forward at the upcoming City Council Operational and Strategic Priority Setting Session in January 2020, it is known that the City will need to explore additional revenue options to bridge the projected deficits and create additional capacity for the City's unfunded future needs and liabilities.

Like many other California cities that are members of CalPERS, one of the largest expenditure risks identified in the forecast is the rising cost of pensions, for both retired and active employees, which are relatively beyond the City's control. For example, on December 21, 2016, the CalPERS Board of Administration lowered the CalPERS discount rate assumption, from 7.5% to 7.0% over three years. Lowering the discount rate means that the City will see increases in both the normal cost (the cost of pension benefits accruing in one year for active members) and the accrued liability for a three-year period with contribution costs increasing effective FY 2018/19. Moreover, it is anticipated that additional reductions to the discount rate assumption may occur in the future.

At the City Council Priority Setting Sessions in January and February 2019, the City Council directed staff to pursue two revenue strategy options, increasing the TOT and establishment of a Utility User Tax. Discussion of some of the preliminary analysis is included below. In addition, staff presented a summary of unfunded capital infrastructure needs. This list is provided in Attachment 1. There are continued concerns that our resource levels are below the levels needed to support the workload and capacity.

To create some capacity for the organization, we are in the process of a major update to the fees charged to users for the cost of services. This represented a critical area in our revenue strategies; however, even with the update to fees, the exploration of additional revenue sources is still required. As part of the City's budget stabilizing strategies and addressing the City's infrastructure needs, staff has reviewed and included analysis for further discussion on revenue opportunities regarding:

1. Increase in the Transient Occupancy Tax (TOT) rate,

2. Establishment of a General Obligation Bond, or
3. Establishment of an Infrastructure Parcel Tax.

The TOT ballot measure would have to be approved at a General election by a simple majority (50% plus 1) of voters. A General Obligation Bond or Infrastructure Parcel Tax would require two-thirds (66.66%) voter approval.

Revenue from the taxes discussed in this report (if approved by the voters) would be used to offset future General Fund deficits and address other service needs such as deferred projects, staffing shortages, etc. It is important to note that these options are revenue opportunities that can be presented to the voters at the appropriate time. Included in the recommendation as part of this report, staff would begin community outreach and stakeholder engagement to test feasibility of the revenue options directed by the City Council.

Staff explored the establishment of a UUT for electric customers including commercial and industrial users. Because of research complexity and complications imposing such a tax on specific key users of electricity, and the difficulties in equitably distributing such a tax, this tax is not recommended at this time until more research and analysis is completed. In addition, staff explored the potential to charge a UUT on residential cable or phone services. Due to the financial impact to potential residents, it is unlikely that such a tax would be approved at the ballot, with community research still required to understand the level of support if both measures are presented to the voters on the same ballot. It is recommended that the City Council pursue the revenue options provided below, as these options are more feasible. Residents would generally not be affected by a TOT rate increase and a General Obligation Bond or Parcel Tax would benefit residents with additional facilities. These options, based on successful ballot measures passed in other neighboring jurisdictions, are recommended for further discussion.

Below is a discussion of three revenue opportunities:

I. Increasing the 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 3.

Table 3 - TOT by Santa Clara County Cities

Transient Occupancy Tax by City

City	Rate
Gilroy	9.0%
Santa Clara (w/o CFD)	9.5%
Morgan Hill	10.0%
Saratoga	10.0%
Fremont	10.0%
Mountain View	10.0%
San Jose	10.0%
Santa Clara (w/ CFD)	11.5%
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 nine hotels that pay CFD special tax, with two proposed to be added on the November 5 Council agenda (RTC #19-1167). 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 nine 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 nine hotels located in the CFD area provide 75% of the City's overall TOT revenue.

Staff has explored two options regarding the City's TOT rate, with Option 1 being a 1% increase and Option 2 being a 2% increase. These increases would affect all hotels in the City. Table 4 below compares last fiscal year's TOT and CFD collections at the City's current 9.5% with the potential additional revenue to be generated with a 1% and 2% increase. Please note the numbers displayed in Table 4 are based on the FY 2018/19 TOT gross receipts.

**Table 4 - Comparison of Potential TOT Revenue
(\$ in millions)**

		TOT TOT Rate Revenue	CFD Revenue (2%)	Total TOT and CFD Revenue
FY 18/19 Actual	9.5%	\$ 22.5	\$ 3.8	\$ 26.3
Option 1 - 1% Increase	10.5%	\$ 24.9	\$ 3.8	\$ 28.7
Option 2 - 2% Increase	11.5%	\$ 27.2	\$ 3.8	\$ 31.0

In FY 2018/19, the City's TOT and CFD collections totaled \$26.3 million. If the TOT rate was increased by 1%, as shown in Option 1, total collections could potentially reach \$28.7 million, an increase of \$2.4 million from last fiscal year. As noted in Option 2, a 2% increase could result in additional revenue of \$4.7 million, bringing total TOT and CFD collections to approximately \$31.0 million.

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 scheduled to be heard at the November 12, 2019 Council meeting.

II. 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 require a two-thirds supermajority vote of the registered voters pursuant to Article XIIC of the State Constitution. GO bonds are secured by levying ad valorem property taxes at 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 5 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%. The table also details the impact to residents 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 5 - 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

III. 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 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. Approval of this 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 (eg. single family home and a larger commercial business). On the other hand, square footage-based measures can be confusing to voters and may be perceived as inequitable as larger parcels would pay a higher tax.

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. Table 6 below illustrates four options for a fixed parcel tax rate and how much each could potentially generate, based on 28,888 taxable parcels. Option 1 shows that should \$230 be taxed per parcel, the City could collect approximately \$6.6 million, which would total roughly the annual debt service payment required for a \$100 million bond issuance, as displayed in Table 5. With each option increase, the parcel tax increases by an additional \$225 per year.

Table 6 - Estimated Revenue on Fixed Parcel Rates per Taxable Parcel

	Bond Issuance Amount	Fixed Rate Per Taxable Parcel	Parcel Tax Revenue
Option 1	\$100 M	\$ 230	\$ 6.6 M
Option 2	\$200 M	\$ 455	\$ 13.1 M
Option 3	\$300 M	\$ 680	\$ 19.6 M
Option 4	\$400 M	\$ 905	\$ 26.1 M

For comparison purposes, the cost of an infrastructure parcel tax to a GO Bond for a typical single-family home valued at \$1 million, a GO Bond would cost \$142 and a fixed parcel tax would cost an owner \$230, assuming \$100 million debt capacity.

Next Steps

Based on direction from Council on the preferred revenue-generating strategy or strategies, the next step would be to retain consultant services to assist the City in the successful passage and implementation of proposed measures on the November 2020 ballot. This would include, but not be limited to: 1) working with City staff to identify priority projects and uses of funds; 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:

- December 2020 - Evaluate community research and outreach consultant and execute contract
- January 2020 - Complete data collection and research including updating list of critical projects for infrastructure measure
- March 2020 - Public outreach/engagement including focus groups and community meetings
- May 2020 - Evaluate engagement results and develop recommendations
- June 2020 - Council decision on ballot measures
- July 2020 - Present proposed ballot language to Council
- August 1, 2020 - Final ballot title and summary due

FISCAL IMPACT

Funding of \$100,000 to provide outreach and community engagement on the ballot measures was included in the FY 2019/20 Adopted Operating Budget. If outreach and engagement costs are higher than the budgeted amount, sufficient funds are appropriated to absorb the difference. Actual November 2020 ballot costs will vary based on the number of ballot measures registered at the County. Budget amendments, if necessary, for ballot measure costs with the County will be recommended separately for Council consideration.

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

1. Review and provide direction on the Potential General Fund Revenue Opportunities for the November 2020 Ballot; and
2. Authorize the City Manager to negotiate and execute agreements with contractors to conduct the required community research and outreach within appropriated funds.

Reviewed by: Kenn Lee, Director of Finance

Approved by: Deanna J. Santana, City Manager

ATTACHMENTS

1. Unfunded Projects and Infrastructure