CITY OF
PALO
ALTO

City Council
Special Meeting
Monday, August 16, 2021
5:00 PM
Council Chambers

BY VIRTUAL TELECONFERENCE ONLY

CLICK HERE TO JOIN **Zoom Meeting ID: 362 027 238** **Phone:1(669)900-6833**

Pursuant to Governor Newsom's Executive Order N-29-20, as amended through order N-08-21, City Council meetings will be held as hybrid meetings with the option to attend by teleconference/video conference or in person. To maximize public safety while still maintaining transparency and public access, members of the public can choose to participate in the meeting from home or attend the meeting in person. Information on how the public may observe and participate in the meeting is located at the end of the agenda.

Public Comments will be accepted both in person and VIA Zoom meeting. All requests to speak will be taken until 5 minutes after the staff's presentation. Written public comments can be submitted in advance to city.council@cityofpaloalto.org and will be provided to the Council and available for inspection on the City's website. Please clearly indicate which agenda item you are referencing in your email subject line.

The meeting will be streamed live on YouTube at https://www.youtube.com/c/cityofpaloalto, and Midpen Media Center https://midpenmedia.org and broadcast on Cable TV Channel 26.

TIME ESTIMATES
Time estimates are provided as part of the City Council's effort to manage City Council meetings. Listed times are estimates only and are subject to change at any time, including while the meeting is in progress. Agenda items may be heard before or after the time estimated on the agenda.

CITY COUNCIL MEETING MATERIALS
Materials related to an item on this agenda submitted to the City Council after distribution of the agenda meeting packet are available for public inspection on the City's website.

AMERICANS WITH DISABILITY ACT (ADA)
Persons with disabilities who require auxiliary aids or services in using City facilities, services or programs or who would like information on the City's compliance with ADA, may contact (650) 329-2550 (Voice) 24 hours in advance.

Call to Order

Special Orders of the Day

Presentation

1. Presentation from Valley Water Regarding the Current State of the Drought

Study Session

Presentation

2. 280 & 300 Lambert Avenue (21PLN-00133): Request for Prescreening of a Proposal by Lambert Fields, LLC to Rezone the Properties at 280 and 300 Lambert Avenue From Service Commercial (CS) to Planned Home Zone (PHZ), Merge Parcels Into One Parcel, and Develop the Site With a 49-unit Residential Development. Environmental Assessment: Not a Project. Zoning District: CS (Service Commercial)

Agenda Changes, Additions and Deletions

Oral Communications

Members of the public may speak to any item NOT on the agenda. Council reserves the right to limit the duration of Oral Communications period to 30 minutes.

Minutes Approval

3. Approval of Action Minutes for the August 9, 2021 City Council Meeting

Consent Calendar

Items will be voted on in one motion unless removed from the calendar by three Council Members.

City Manager Comments

Action Items

Include: Reports of Committees/Commissions, Ordinances and Resolutions, Public Hearings, Reports of Officials, Unfinished Business and Council Matters.

Presentation

4. Finance Committee Recommends the City Council Decline to Adopt the Energy Storage System Targets; and Receive the 2020 Energy Storage Report

Presentation

5. Approve the Workplan for Development of a Revenue-Generating Local Ballot Measure for the November 2022 General Election; Review and Potential Guidance to Staff on Affordable Housing Funding as Referred by the City Council

Council Member Questions, Comments and Announcements

Members of the public may not speak to the item(s)

Closed Session

Public Comments: Members of the public may speak to the Closed Session item(s); three minutes per speaker.

6. CONFERENCE WITH REAL PROPERTY NEGOTIATORS

Authority: Government Code Section 54956.8
Property: 300 Homer Avenue, Assessor's Parcel Number 120-17-093
Negotiating Party: Palo Alto Museum
City Negotiators: Ed Shikada, Kiely Nose
Subject of Potential Negotiations: Lease Price and Terms of Payment

Adjournment

AMERICANS WITH DISABILITY ACT (ADA)
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Additional Information

Supplemental Information

Informational Report

Standing Committee Meetings

Finance Committee Meeting August 17, 2021 6:00 PM

Schedule of Meetings

7. Schedule of Upcomming Meetings from the City Clerk

Public Letters to Council

8. Public Letters to Council from the City Clerk

City of Palo Alto

(ID # 12325)

City Council Staff Report

Report Type: Study Session **Meeting Date: 8/16/2021**

Summary Title: 280 & 300 Lambert Avenue: PHZ Prescreening for 49 Units

Title: 280 & 300 Lambert Avenue (21PLN-00133): Request for Prescreening of a Proposal by Lambert Fields, LLC to Rezone the Properties at 280 and 300 Lambert Avenue From Service Commercial (CS) to Planned Home Zone (PHZ), Merge Parcels Into One Parcel, and Develop the Site With a 49-unit Residential Development. Environmental Assessment: Not a Project. Zoning District: CS (Service Commercial)

From: City Manager

Lead Department: Planning and Development Services

Recommendation

Staff recommends that Council conduct a prescreening review and provide informal comments regarding the applicant's rezoning request.

Executive Summary

The applicant requests a pre-screening review by Council of an application to rezone the subject property (two parcels) from Service Commercial (CS) to "Planned Home Zoning (PHZ)".[1] The applicant's project would include demolishing the existing commercial buildings, merging the parcels, and developing a residential-only project.

The prescreening application is required by PAMC 18.79.030 and responds to the City Council's expressed interest in learning from home builders what it takes to create more housing opportunities in Palo Alto. A PHZ application must meet two initial qualifying criteria established by the City Council: 1) provide 20% of the total units as income-restricted inclusionary housing, and 2) provide more housing units than required for any net new jobs on the project site.

[1] Referred to in this report as "Planned Home Zone" to emphasize the focus on housing as the benefit to the community. PAMC Section 18.38, which outlines the requirement and process for Planned Community (PC) Zoning, remains the underlying code supporting application of this policy.

The conceptual project replaces two automobile service buildings totaling 10,125 square feet with a residential building with 49 housing units (23 one-bedroom units; 21 two-bedroom units; and five three-bedroom units). There would be 10 income-restricted housing units meeting the 20 percent inclusionary requirement. The proposal would not meet the base zoning district development standards for floor area, height, site coverage, density, and rear setback.

North Ventura Coordinated Area Plan (NVCAP)

The project site is within the NVCAP, which is currently a coordinated area plan under review. City Council reviewed the NVCAP on June 14, 2021 (ID #11930)[2]. The NVCAP project area lies within the Ventura neighborhood of Palo Alto. It is comprised of approximately 60 acres, roughly bounded by Page Mill Road, El Camino Real, Lambert Avenue, and the Caltrain tracks. The plan area is near local and regional destinations. These include the California Avenue Caltrain Station, California Avenue Business District, and Stanford Research Park. Presently, the NVCAP is in the "Community Engagement and Analysis" phase of the process and not a final, Council-adopted plan.

The prescreening request is a study session discussion only, and no formal action will be taken by the City Council.

Background

Since February 2020, the City Council endorsed using PHZ for housing and mixed-use housing projects to help spur housing production. PHZs allow a home builder to share a plan for adding housing, but also include one or more requests to modify local zoning standards. In exchange for modifying certain development standards, the project must include at least 20% of the housing units as affordable through a menu of options including a combination of inclusionary housing and payment of an in-lieu fee. Moreover, the number of housing units must offset the number of net new commercial jobs that are generated by the project.

In accordance with Palo Alto Municipal Code (PAMC) Section 18.79.030(A), a prescreening review is required for legislative changes, including rezoning, before the submittal of a formal application. Prescreening applications are intended to solicit early feedback on proposed projects and, like all study sessions, cannot result in any formal action. Because this proposal may return to the City Council as a quasi-judicial application, Councilmembers should refrain from forming firm opinions supporting or opposing the project.

[2] June 14, 2021 CMR on NVCAP https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/2021/id-11930.pdf

City Council PHZ Program Refinements

The City Council endorsed staff's proposed approach for the inclusionary housing options and the formula to determine the jobs/housing ratio on September 21, 2020.[3]

On April 12, 2021, the City Council discussed and updated parameters it would consider for future PHZ applications.[4] While the multi-part motion included several future considerations, more immediately, the Council's motion directed PHZ applications meet the following criteria:

- Clarify that the PHZ has been intended to only apply to housing incentive program (HIP) areas, other commercial districts and zone districts allowing higher density housing, excluding areas east of 101;
- Provide parameters for what is meant by "moderate adjustments to base zoning for PHZ projects";
- Clarify that the PHZ must be predominantly housing and only a minority component of office development;
- PHZ is prohibited in R-1, R-2, and RE zoning, except for projects that have already been prescreened; and
- Allow PHZ in light industrial areas if it is a compatible use.

As proposed, the pre-screening concept meets these parameters. The project proposes floor area ratio, lot coverage and density that are consistent with other PHZ prescreening applications. The proposed height is 10% more than the maximum allowed by the zoning code.

Project Description

The owner, Lambert Fields, LLC, requests a prescreening review for a conceptual residential project containing 49 dwelling units. A location map is included in *Attachment A*; and the preliminary schematic drawings are included in *Attachment D*.

The applicant proposes to demolish the existing commercial buildings on two adjacent properties (280 and 300 Lambert Avenue) and merge the two parcels. The resulting merged lot area would be 25,591 square feet. The project concept plans show two massing components separated by a courtyard. One component is a three-story multi-family building that would be located towards the front of the property. The other component is a five-story multi-family residential building to be placed towards the rear of the property. Parking spaces for the site

[3] Link to September 21, 2020 Council Staff Report: https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=43675.41&BlobID=78363.

[4] Action Minutes for the April 12, 2021 Council hearing are available at: https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2021/04-12-21-ccm-draft-action-minutes.pdf

would be in a basement garage below the buildings, using a combination of mechanical lift spaces and standard spaces.

The proposed floor area would be 70,325 square feet (excluding required parking area per PAMC Section 18.04.030(a)(65)(B)), resulting in a floor area ratio (FAR) of 2.66 to 1. The front building would be 35-feet tall with 10 townhouse-style condominium units, with three levels above ground, and one habitable level below grade. The five-story, 55-foot building at the rear of the property would include 39 condominium units. The applicant currently proposes 10 inclusionary units consistent with Option 1 (20% Deed Restricted; balanced across affordable and workforce housing) described in the September 21, 2020, City Council report.

Discussion & Summary of Key Issues

As shown in the zoning comparison table in *Attachment B*, the project does exceed a few of the development standards contained in the base zoning district as well as one of the requirements in the Planned Community special requirements section (PAMC 18.38.150).

Consistency with the Comprehensive Plan, Area Plans and Guidelines[5]

The Comprehensive Plan Land Use Designation for the site is Service Commercial, which includes facilities providing citywide and regional services and relying on customers arriving by car. These uses do not necessarily benefit from being in high volume pedestrian areas such as shopping centers or Downtown. Typical uses include auto services and dealerships, motels, lumberyards, appliance stores and restaurants, including fast service types. In almost all cases, these uses require good automobile and service access so that customers can safely load and unload without impeding traffic.

In some locations, residential and mixed-use projects may be appropriate in this land use category. Examples of Service Commercial areas include San Antonio Road, El Camino Real and Embarcadero Road northeast of the Bayshore Freeway. Non-residential FARs will range up to 0.4. Consistent with the Comprehensive Plan’s encouragement of housing near transit centers, higher density multi-family housing may be allowed in specific locations.

The project site is near El Camino Real, which has high quality transit, and within a half-mile of the California Avenue Train Station. Therefore, the project appears to be consistent with the Comprehensive Plan land use designation.

North Ventura Coordinated Area Plan

The project is located within the NVCAP. The NVCAP is an area that the Comprehensive Plan

[5] The Palo Alto Comprehensive Plan is available online: https://www.cityofpaloalto.org/Departments/Planning-Development-Services/Long-Range-Planning/2030-Comprehensive-Plan

identified for site specific planning and the development of the plan is currently underway. The project mostly appears to be consistent with the range of alternatives discussed[6], including the amount of affordable housing proposed. As well, it is near the expected height that would be allowed for buildings. The proposed project does not include the creek amenity and trail envisioned in all Alternatives.

Since the NVCAP is not an adopted plan at this time, the analysis of the proposed project's consistency would not be applicable. On balance, the project appears to be consistent with many of the City Council's goals for the plan.

Zoning Compliance[7]

The PHZ application provides a path for home builders and the City Council to consider adjustments in zoning that stimulate more housing units. However, Council expressed in its motion on April 12, 2021, that it intends the PHZ to be used for modest changes to the existing zoning regulations of a property.

PAMC Section 18.38.150 sets forth special standards for projects looking to utilize the PC zoning district and that are adjacent to low density residential zone districts, including the R-1 zone district. These include special setbacks, daylight plane, and height requirements. As shown in Attachment B, the project meets these requirements except for PAMC Section 18.38.150(b), where the special standard restricts height to 50 feet. The project includes an element that is 55 feet in height or 10% greater than the standard.

A review of the conceptual plans against the CS zoning standards shows that the project would not meet some of the zoning requirements for mixed-use or residential development, as shown in *Attachment B*. The project would need to vary from the base zoning to allow for the requested height, floor area ratio, site coverage, density, and rear setback. The proposed open space does appear to be consistent with the development standards; however, the project lacks details for a full evaluation currently on that issue. These deviated development standards appear to be like those seen in other prescreening applications using the PHZ process. These are described in greater detail in the following sections.

Height

The 35 feet proposal for the front-placed building is consistent with the development standards acknowledging a transition to lower height development across Lambert Avenue. The rear building element of the project, at a height of 55 feet, would be five feet taller (10%) than what

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[6] June 14, 2021 City Council Staff Report regarding NVCAP Plan Alternatives: https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/2021/id-11930.pdf

[7] The Palo Alto Zoning Code is available online: http://www.amlegal.com/codes/client/palo-alto_ca

is allowed by the base zoning and the special standards contained within PAMC Section 18.38.150 for PC zones. This proposed height also exceeds the recommended height maximum in the NVCAP for the site. However, NVCAP Alternatives 2 and 3B would allow an additional five feet in height for buildings with ground floor retail.

Currently, no other building within the vicinity of the site is taller than two stories. The rear building includes a portion that is approximately 150 feet away from the R-1 (Single-Family Residential) zoning district across from Lambert Avenue. As seen from across Lambert Avenue, the front building would limit the view and massing of the rear building. It is expected that the area within the NVCAP will transition to development with taller buildings consistent with the proposal.

Floor Area Ratio, Site Coverage, Density
Consistent with other prescreening projects proposing to use the PHZ process, the project would exceed standards for the base district FAR (2.66:1 versus 0.6:1), site coverage (62% versus 50%) and density (80.3 units/acre versus 30 units/acre).

Rear Setback
The first floor of the rear building does not meet the minimum setback set forth in the base zoning district (5’-6” is proposed versus 10 feet required). The upper floors of the building are compliant with the standard (14’-7”). Staff discussed with the applicant providing a larger ground floor setback near Matadero Creek. This would allow additional area for a pedestrian access easement that could be applied to open space requirements, consistent with NVCAP goals for an amenity space along Matadero Creek. This concept should be further pursued if the project moves forward.

Parking
The applicant would request a 14.67% reduction in the number of parking spaces typically required per the City’s multi-family residential parking standards. Such a reduction could be supported based on submittal of a robust Transportation Demand Management plan (PAMC 18.52.050). If Council adopts NVCAP recommendations, the project would be consistent with a parking ratio proposed in Alternative 3 of one space per housing unit, and would not need approval of a parking reduction.

Policy Implications

As noted, the project lies within the NVCAP area and City Council reviewed several plan alternatives on June 14, 2021. Council continued the item to Fall 2021 (currently scheduled for September 20, 2021). Discussion was captured in video format.[8]

[8] Video of Council meeting June 14, 2021, item 9 (NVCAP) https://midpenmedia.org/city-council-152-6142021/

Each PHZ that is presented to the City Council represents the unique challenges individual developers face with specific lot constraints and their willingness to accept various returns on cost or yield for the project. This project does not include office space or other commercial space. This approach would provide more housing to help alleviate the City's jobs-housing imbalance. The applicant indicated in their project description (*Attachment C*) that the additional height would allow for additional floor area for residential units and would make the project financially feasible.

The plans and compliance review in this report are preliminary. The purpose of the prescreening process is not to exhaustively review a project for compliance with code or require significantly detailed plans, which may change before a formal application is filed. However, staff presented several key development standards for Council discussion of this prescreening application.

Prescreening reviews are intended to solicit early feedback on proposed projects and, like all study sessions, cannot result in any formal action. Therefore, informal comments from Councilmembers would not have any policy implications.

Resource Impact

Staff time processing this prescreening as well as any future application is subject to cost recovery.

Timeline

Following the prescreening review, the applicant will consider Council's comments and determine how they want to proceed. Any formal application to rezone the property to a planned community zone would be subject to review by the Planning and Transportation Commission and Architectural Review Board prior to City Council review.

Stakeholder Engagement

This item was published in the Daily Post on August 6, 2021, which is 11 days in advance of the meeting. Postcard mailing occurred on August 2, 2021, which is 14 days in advance of the meeting.

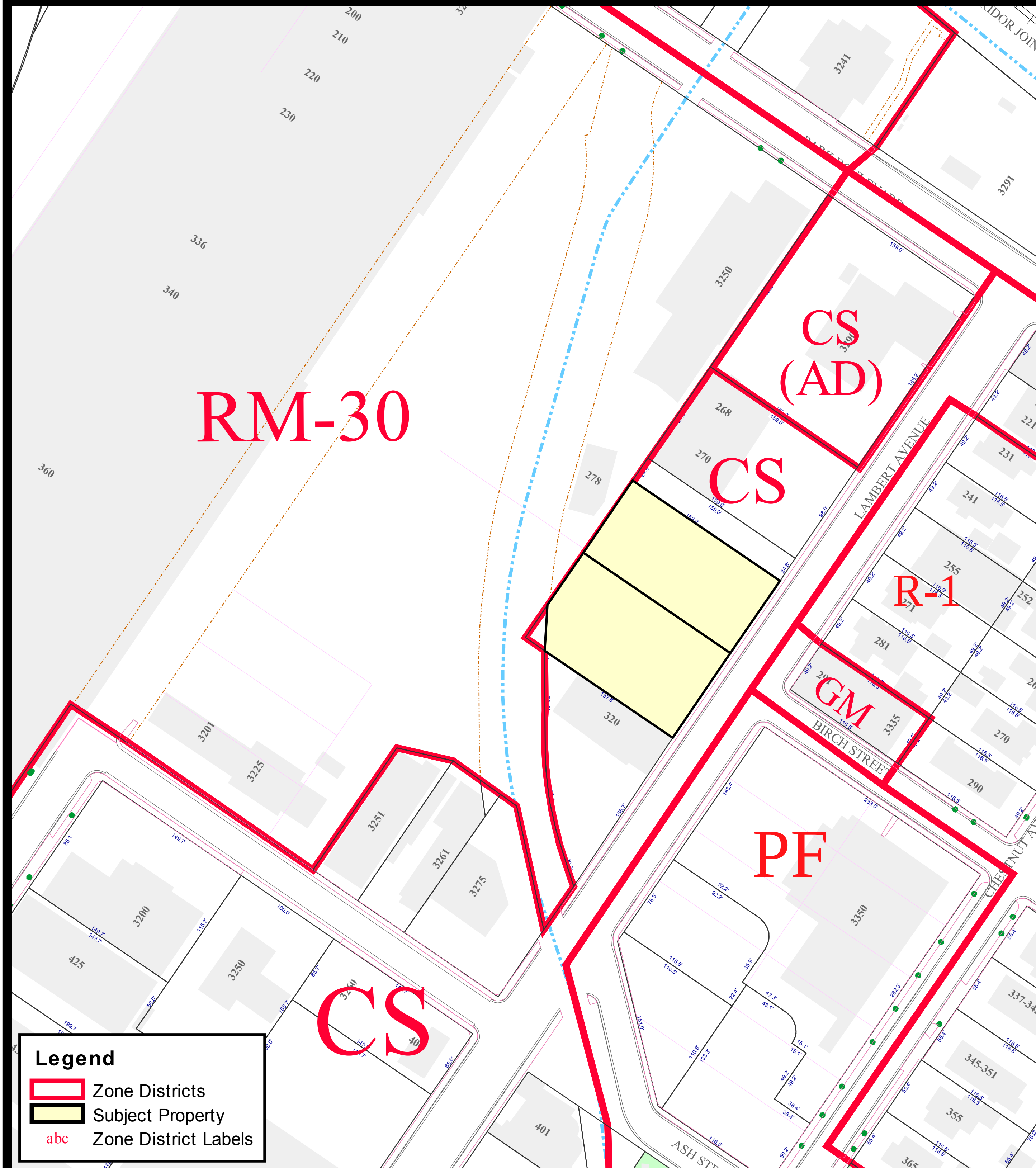
Environmental Review

The prescreening application involves no discretionary action and is therefore not subject to review pursuant to the California Environmental Quality Act. Subsequent project applications will require project-specific environmental analysis.

Attachments:

Attachment2.a: Attachment A: Location Map(PDF)

Attachment2.b: **Attachment B: Zoning Comparison Table (DOCX)**
Attachment2.c: **Attachment C: Applicant's Project Description (PDF)**
Attachment2.d: **Attachment D: Project Plans (DOCX)**



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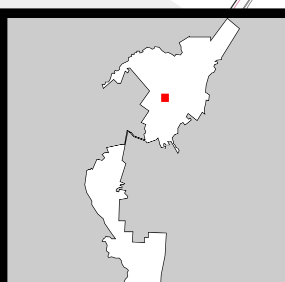

Location Map
280 & 300 Lambert Ave

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ATTACHMENT B
ZONING COMPARISON TABLE
280 & 300 Lambert Avenue, 21PLN-00133

Table 1: COMPARISON WITH CHAPTER 18.16 (CS DISTRICT) *Bold indicates exceedance of special standards for Planned Community/PHZ projects			
Regulation	**Required CS**[1]	**Existing**[2]	**Proposed**[3]
Minimum Site Area (ft) **Site Width (ft)** **Site Depth (ft)**	None Required	25,591 sf (two parcels) 169'-7" 159'-0"	No Change
Minimum Setbacks (ft)			
Front Yard	0 – 10 feet to create an 8 – 12 feet effective sidewalk width	280 Lambert: 0 feet 300 Lambert: 0 feet	**6 ft 11-inch sidewalk** with 2-foot landscape setback Portion of property opposite of R-1 district: (20 feet required per PHZ special standards)[4]
Rear Yard	10 feet (for lots abutting a residential zone district)	280 Lambert: 5'-6" 300 Lambert: 5 feet	**1st floor: 5'-6"** Upper floors: 14'-7"
Interior Side Yard	10 feet (for lots abutting a residential zone district)	280 Lambert: 0 feet / 45 feet 300 Lambert: 34 feet / 0 feet	10 feet
Street Side Yard	5 feet	Not applicable	Not applicable
Build-to-Lines	50% of frontage built to setback.	280 Lambert: 44% (34 ft 6 inches) 300 Lambert: 65% (60 ft)	75.5% (128 ft)
Minimum Site Open Space (percent)	30% (7,677 sf)	Not applicable	39.29% (10,447 sf)[6]
Minimum Usable Open Space (sf per unit of Common and Private)	150 sf per unit[5]	Not applicable	183 sf per unit[6]
Max. Building Height	50 feet		**Rear portion of building: 55 feet** **(50 feet required per PHZ special standards)**[7]
Maximum height within 50 ft. of a residential zone district (other than an RM-40 or PC zone)	35 feet (35 feet, within 150 feet of RE, R-1, R-2, RM, or PC district per PHZ standards)	280 Lambert: 15 feet 300 Lambert: 14 feet	Front portion of building: 35 feet (building is over 66 feet from R-1 zone property)

Daylight Plane for lot lines abutting one or more residential zoning districts	Daylight plane height and slope shall be identical to those of the most restrictive residential zoning district abutting the lot line	Not applicable	None is required. No daylight plane required when abutting RM-30 when the lot is wider than 70 feet.
Max. Site Coverage	50%	280 Lambert: 26% (3,375 sf) 300 Lambert: 47% (6,750 sf) Combined: 38% (10,125 sf)	**62% (16,583 sf)**
Max. Floor Area Ratio	0.6:1	280 Lambert: 0.26:1 (3,375 sf) 300 Lambert: 0.47:1 (6,750 sf) Combined: 0.37:1 (10,125 sf)	**2.66:1 (70,641 sf)**
Maximum Residential Density per acre (net)	30 units/per acre	None	**80.3 units/acre (49 units)**

(1) From Table 4 (Chapter 18.16.060) for Mixed-Use and Residential Standards
(2) The existing sites include non-residential uses.
(3) 100% residential project
(4) Chapter 18.38.150(d) On any portion of a site in the PC district, which is opposite from a site in any RE, R-1, R-2, RM or applicable PC district, and separated therefrom by a street, alley, creek, drainage facility or other open area, a minimum yard of 10 feet shall be required. Where a use in a PC district where the gross floor area, excluding any area used exclusively for parking purposes, is at least sixty percent residential, the minimum yard requirement shall be at least as restrictive as the yard requirements of the most restrictive residential district opposite such site line. The minimum yard shall be planted and maintained as a landscaped screen, excluding areas required for access to the site.
(5) Required usable open space: (1) may be any combination of private and common open spaces; (2) does not need to be located on the ground (but rooftop gardens are not included as open space except as provided below); (3) minimum private open space dimension six feet; and (4) minimum common open space dimension twelve feet.
(6) Conceptual number that will be verified when a formal application is submitted for review.
(7) Chapter 18.38.150(b) All Other Uses. The maximum height within one hundred fifty feet of any RE, R-1, R-2, RM, or applicable PC district shall be thirty-five feet; provided, however, that for a use where the gross floor area excluding any area used exclusively for parking purposes, is at least sixty percent residential, the maximum height within one hundred fifty feet of an RM-4 or RM-5 district shall be fifty feet.

Table 2: CONFORMANCE WITH SECTION 18.52 (Off-Street Parking)
for Multi-Family Residential Uses

Type	Required	Existing	Proposed
Vehicle Parking	1 space per studio and one-bedroom; 2 spaces per two-bedroom unit 1-Bedroom: 23 units = 23 spaces 2-Bedroom: 21 units = 42 spaces 3-Bedroom: 5 units = 10 spaces Total: 75 spaces	31 spaces	**64 spaces**[1]
Bicycle Parking	1 space per unit/100% long term (LT) 1 space per 10 units short term (ST)	None	Unclear[2]

(1) Proposes Transportation Demand Management plan to reduce parking by 14.67%. NVCAP parking requirements if adopted may not require reduction request for project.
(2) Project includes “Bike Parking” room with undisclosed amount of LT parking. Site has space for ST parking.

June 10th, 2021

Sheldon Ah Sing
Senior Planner
City of Palo Alto
Planning & Development Services Department
285 Hamilton St, 1st Floor
Palo Alto, CA 94301

DEVELOPMENT PROGRAM STATEMENT & SCHEDULE

RE: 300 LAMBERT AVE - PHZ PRE-SCREENING SUBMITTAL

Dear Mr Sing,

On behalf of our client Peninsula Land & Capital, Hayes Group Architects submits this development program Statement pursuant to PAMC 18.38.070 for a proposed multi-family residential development at 280 and 300 Lambert Avenue in South Palo Alto. The proposed development consists of forty-nine (49) for-sale residential condominium units and associated common area for parking, utilities and resident amenities. This proposal is contingent on the use of PHZ (PC) zoning regulations outlined in Palo Alto Municipal Code (PAMC) section 18.38.

PROJECT SUMMARY

The site consists of 2 parcels that will be merged, with addresses of 280 and 300 Lambert Avenue. The combined site area is 26,591 SF (0.61 acres). The proposed floor area is 70,735 SF, resulting in an FAR of 2.66:1. All parking is proposed on-site in a single level underground garage, with the majority of parking stalls provided in mechanical lifts. Based on a Transportation Demand Management Plan with a 14.67% reduction the project is fully parked with 64 stalls.

The proposed design is organized into 2 major massing elements. The front mass is aligned parallel to lambert street and is 3 stories tall and 35 feet high as measured to the middle of the sloped roofs. A total of ten (10) townhouse style condo units are contained in this front portion of the project; six units located above grade on levels 2 and 3, and four units accessed from the ground level directly from Lambert Avenue. These 4 lower units extend down into the basement and have outdoor light and air courts at the lower level. The roof line is articulated with individual shed roofs at each of the 6 upper townhouse units, establishing a modest scale and creating a direct connection of residences to the street.

The second massing element also runs parallel to Lambert street but is set back towards the rear of the property, creating an interior courtyard in the center of the project. This central courtyard serves as the primary entrance court to the rear portion of the project. This rear element contains 39 residential condos as well as shared amenity space at the ground and second floors. This rear element is proposed to be five (5) stories tall and 55 feet high measured to the top of parapet surrounding a flat roof. This proposed height exceeds the maximum of 50 feet outlined in the municipal code. This additional 5 feet (or 10%) of building height allows for the construction of an additional floor of residential units which makes a

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significant difference in the financial viability of the project, specifically the ability of the project to offset the cost burden of the 20% affordable requirement.

The southeast corner of the rear massing element is located within 150 feet of the neighboring R-1 lot directly across the street. To achieve the intent of the applicable height limits established in the municipal code (to create a gradual transition between lower density and higher density uses) the overall massing concept described above allows the project to establish a neighborhood friendly 35 foot height along Lambert Avenue while effectively screening the taller portion of the project behind it. When viewed from the R-1 parcels across the street the shorter 3-story element will mostly conceal and will appear taller than the five-story element at the back. This can be seen in the conceptual building section and the perspective views provided in the attached development plans.

PROGRAM STATEMENT

Application of PHZ designation for this project is necessary for the following reasons:

a. The underlying Zoning designation of CS would only allow for an FAR of 0.6:1, and site coverage would be limited to 50%, with a maximum density of 30 du (development units per acre). This limited development potential severely limits the number of housing units that can be built. Coupled with the high price of land it also further challenges the inclusion of affordable housing. Under these regulations the site would be limited to a maximum of 18 residential units but would more likely result in 12 or so units due to practical realities. Application of PHZ regulations would allow for roughly a four-fold increase in unit count as illustrated in the attached plans. The proposed residential use is compatible with the surroundings as there are parcels designated R-1 and RM-30 in the immediate vicinity, and Lambert street marks the transition from the more commercial area of the North Ventura neighborhood to the more residential South Ventura neighborhood.

b. The proposed uses in this project are limited to private residential condominiums, including support and amenity spaces related to residential use. Support and amenity spaces include parking, mechanical and storage spaces, shared circulation, utilities, trash & recycling, and undetermined amenity spaces such as a common area lounge or exercise space.

c. The nature of all proposed uses is that of residential living and associated activities. Each residential unit will contain its' own private kitchen and bathing facilities, with all parking located below grade. Portions of the site are designed as usable outdoor space for the condominium users and their guests to use.

d. Below is a schedule of unit types and sizes and anticipated sales prices. Please note that sales prices are based on an estimated sales price of $1,250 per occupied square foot, not including common areas such as parking and utilities etc.

unit description	BR#	unit size	quantity	sales price
3 BEDROOM	3BR	1,800 SF	4	$2,250,000
2 BEDROOM TOWNHOUSE	2BR	1,450 SF	10	$1,812,500
2 BEDROOM AT GRADE	2BR	1,400 SF	4	$1,750,000
2 BEDROOM ABOVE GRADE	2BR	1,300 SF	5	$1,625,000
1 BEDROOM CORNER UNIT	1BR	840 SF	8	$1,050,000
1 BEDROOM ABOVE GRADE	1BR	790 SF	9	$987,500
TOTAL:			**49**	

Note: Sales prices shown above are for market rate units. 20% of units will be sold as BMR units. Pricing for Below Market Rate units shall be established by the Director of Planning & Development Services in accordance with the City's website.

DEVELOPMENT SCHEDULE

Planning Entitlements:	15 months
Detailed Design:	6 months
Permitting:	6 months
Construction:	15 months
Total:	**42 months** (3 ½ years)

If you have any questions regarding the contents of this letter or the accompanying plans, please feel free to contact me by phone or email.

Sincerely,

Jeff Galbraith
Principal
Hayes Group Architects Inc.
(650) 223-4026
jgalbraith@thehayesgroup.com

Attachment D

Project Plans

Project plans are available online, as shown below..

Directions to review Project plans online:

1. Go to: bit.ly/PApendingprojects
2. Scroll to find "**300 Lambert Avenue**" and click the address link
3. On this project specific webpage you will find a link to the Project Plans and other important information

Direct Link to Project Webpage:

https://www.cityofpaloalto.org/News-Articles/Planning-and-Development-Services/300-Lambert-Ave-21PLN-00133

CITY OF PALO ALTO OFFICE OF THE CITY CLERK

August 16, 2021

The Honorable City Council
Palo Alto, California

Approval of Action Minutes for the August 9, 2021 City Council Meeting

Staff is requesting Council review and approve the Action Minutes from the August 9, 2021 meeting. The draft minutes will be provided on or before August 12, 2021.

Department Head: Lesley Milton, City Clerk

City of Palo Alto
City Council Staff Report

(ID # 12194)

Report Type: Action Items **Meeting Date: 8/16/2021**

Summary Title: Energy Storage AB 2514 Report

Title: Finance Committee Recommends the City Council Decline to Adopt the Energy Storage System Targets; and Receive the 2020 Energy Storage Report

From: City Manager

Lead Department: Utilities

RECOMMENDATION

Staff and the Finance Committee recommend that the City Council decline to adopt energy storage system targets under California Assembly Bill (AB) 2514 at this time, and that Council receive the 2020 City of Palo Alto Utilities Energy Storage Report. The CPAU 2020 Energy Storage Report (linked here)[1] was also submitted to the California Energy Commission (CEC) in December of 2020.

EXECUTIVE SUMMARY

California law AB 2514 (2010, as amended) requires all California publicly owned utilities to investigate whether energy storage systems are cost effective every three years (Public Utilities Code § 2836(b)). Most recently in 2017 City of Palo Alto Utilities (CPAU) staff examined energy storage systems,[2] determined that they were not cost effective for CPAU, and therefore declined to set energy storage targets.

To investigate if energy storage located in the City of Palo Alto was financially beneficial to all customers, CPAU built an economic battery dispatch model and worked on a joint analysis with the Smart Energy Power Association (SEPA) with other publicly owned utilities through the Northern California Power Agency (NCPA) and Sacramento Municipal Utility District (SMUD).

The CPAU and SEPA analyses both suggest that for Palo Alto customer-sited energy storage is still not cost-effective from a societal perspective (for the utility and customers in aggregate). Since neither energy storage within the City nor on the transmission system was found to be cost effective for the utility or its customers as a whole, staff recommends declining to set energy storage system targets at this time.[3] Instead CPAU will continue to monitor this rapidly maturing space and continue looking for specific projects which by virtue of their location could provide extraordinary resiliency, lower carbon emissions, and/or lower distribution system costs. Staff is also currently evaluating multiple proposals

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[1] https://efiling.energy.ca.gov/GetDocument.aspx?tn=236202-1&DocumentContentId=69171
[2] https://www.cityofpaloalto.org/civicax/filebank/documents/57435
[3] Under state law (PUC 2836(b)), local publicly owned electric utilities like CPAU must analyze the merits of ESS investments periodically and set goals if such investments are cost effective.

for utility-scale storage co-located with renewable generation and will move forward with competitive projects that complement CPAU's existing supply portfolio.

In December of 2020 UAC unanimously accepted the staff recommendation to not set energy storage system targets (Staff Report ID #11357[4]). The UAC discussion focused on:

1. Whether utility-scale storage was cost-effective even if small storage was not. Staff responded that CPAU is currently evaluating competitive storage proposals at utility-scale renewable electricity generation sites.
2. What carbon price would be required to make customer-sited energy storage systems cost-effective. Staff responded that there was relatively little carbon saved per dollar in the customer-sited storage sites since installed battery costs are still high and there are losses in the battery. A carbon price higher than $200 per metric ton of carbon dioxide equivalent (MT CO_2-e) would likely be needed based on today's installed battery costs and efficiencies for the residential scenarios examined. The market price for carbon reductions in the electric system,[5] which would be the appropriate value for evaluating energy storage, is estimated to be approximately $30 to $60 per MT CO_2-e based on the current price of renewable energy in California.
3. How the utility could send appropriate price signals to customers with energy storage to ensure they operated it in a way that was beneficial to the community, utility, and electric grid as a whole. Staff responded that sending the appropriate price signal is exactly what smart meters and smart devices are meant for once those are installed.

Staff presented this recommendation to the Finance Committee on April 20, 2021 Staff Report No. 12142 (Linked Document). The Finance Committee voted 2 to 1 with Chair Cormack and Council Member Filseth voting in favor to recommend that the Council not set energy storage targets and accept the 2020 Energy Storage Report and Vice Mayor Burt voting no. The full Finance Committee was in agreement that declining to set goals was the appropriate action given that the study showed energy storage was not cost effective as an energy supply strategy. But there was disagreement about how quickly to complete the six additional efforts listed below under "Next Steps," with Vice Mayor Burt advocating to have staff return to Finance Committee with a plan to accelerate exploration of these six areas and the resources needed.

CPAU submitted the "City of Palo Alto Utilities 2020 Energy Storage Report"[6] to the CEC in December 2020. The 2020 report includes:

1. An overview of customer adoption of Energy Storage Systems (ESS) in Palo Alto;
2. Analysis of the cost-effectiveness of customer-sited ESS within Palo Alto; and
3. Next steps for ESS both within Palo Alto and sited at utility-scale renewable generation.

BACKGROUND

The deployment of ESS in the California electricity sector has grown rapidly in recent years due to declining cost, regulatory mandates for investor-owned utilities (IOUs) to procure and/or provide

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[4] http://cityofpaloalto.org/civicax/filebank/documents/79337

[5] The market price for carbon is lower than the long-term carbon price needed to achieve global emissions reductions to curtail global warming. The latter is significantly higher and includes more expensive emissions reductions not currently being widely implemented. However, because energy storage competes with renewable energy to curtail electricity grid emissions, the market price for carbon is a more appropriate measure.

[6] https://efiling.energy.ca.gov/GetDocument.aspx?tn=236202-1&DocumentContentId=69171

rebates for customer sited ESSs, availability of reliable system manufacturers/installers, federal tax credits, and increased customer awareness of the benefits ESS.[7] IOUs have been authorized to collect over $1B from their customers to be spent on the state-mandated storage program for IOU territory, which is called the Self Generation Incentive Program (SGIP).

On a very basic level, energy storage systems can be used to allow energy generated at one time to be utilized later. This opens up a number of possible value streams as shown in the CPAU 2020 Energy Storage Report.[8] This list of value streams is consistent with other analyses of value streams, such as those shown in the 2017 Rocky Mountain Institute Storage Report.[9]

Despite energy storage systems being able to provide multiple values, the actual installation of batteries in California has not always been economically or environmentally beneficial. A recent evaluation[10] of the Self Generation Incentive Program found that on average commercial storage projects without performance-based incentives increased carbon emissions. This was primarily[11] due to commercial customers using their batteries during the times of cleanest electricity and charging their batteries during the times of dirtier electricity (which is typical for maximizing savings from commercial demand charges).

DISCUSSION

The CPAU and SEPA analyses both suggest that for Palo Alto, customer-sited energy storage is still not cost-effective from a societal perspective (for the utility and customers in aggregate). Details on the analysis and results are in the CPAU 2020 Energy Storage Report.

Since neither energy storage within the City nor on transmission system were found to be cost effective for the utility or its customers as a whole, CPAU will not be setting storage goals at this time. Instead CPAU will continue to facilitate customer-funded installations through education and group buy programs, monitor this rapidly maturing space, and continue looking for specific projects which by their location could provide extraordinary resiliency, lower carbon emissions, and/or lower distribution system costs. Staff is also currently evaluating multiple proposals for utility-scale storage located with renewable generation and will move forward with competitive projects that complement our existing supply portfolio.

Areas of Unique Value of Energy Storage to CPAU

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[7] It is estimated battery costs have declined by 50% over the past 3 years, with the corresponding battery ESS cost declining by 30%. Under California Public Utilities Commission (CPUC) mandates, the IOU/CCAs were required to contract for 2,485 MW of ESS by 2020. In addition, CPUC requires IOUs to provide cash rebates to customers installing ESS under the Self-Generation Incentive Program (SGIP). The increased wildfire risks and associated public-safety-power-shutoff measures have increased the customer's need for back-up power sources, which ESS are well suited to provide.

[8] https://efiling.energy.ca.gov/GetDocument.aspx?tn=236202-1&DocumentContentId=69171

[9] https://rmi.org/wp-content/uploads/2017/03/RMI-TheEconomicsOfBatteryEnergyStorage-FullReport-FINAL.pdf

[10] https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/Utilities_and_Industries/Energy/Energy_Programs/Demand_Side_Management/Customer_Gen_and_Storage/2017_SGIP_AES_Impact_Evaluation.pdf

[11] 10% of the emissions increase was due to parasitic losses within the battery, but 90% of the emissions increase was due to the commercial customers operating the batteries to lower their utility demand charges rather than lower carbon or wholesale energy costs.

Although the current analyses suggest energy storage within CPAU territory is not financially beneficial to all customers, there are a number of factors which could change this in the future. These factors do not currently outweigh the costs of storage, but there is the potential for this to change in the future based on: higher future resiliency value to community, statewide energy supply shortages or interruptions, different structure proposed for transmission charges, and rapid electrification of particular residential neighborhoods.

Factors which would Improve Future Energy Storage Value to CPAU & Customers

1. Increased community value of local resiliency: The recent electricity supply shortages at the state level and potential future disruptions from large-scale regional wildfires could lead the community to elect to pay a premium for local electricity storage.

2. Insufficient distribution system capacity in residential areas: Energy storage could help distribution system costs, in particular for neighborhoods rapidly switching to all electric homes which also have a high penetration of electric vehicles. Where there is not currently enough distribution system capacity, batteries may have the potential to be leveraged as "non-wires solutions" if exercised appropriately.

3. Increased wholesale value of flexible resources: The recent supply shortages at the state level could indicate that flexible electricity generation is currently underpriced and undervalued. Flexible resources such as batteries could be worth more in the future if this trend holds, especially as more natural gas generation is retired in California.

4. Reconfiguration of transmission charges: The primary transmission operator of California is considering redistributing transmission charges in a way which would make flattening electricity demand more valuable. This would increase the value of storage as one way to flatten electricity demands, at a City level.

5. CPAU's Hourly Carbon Neutral Standard: In August 2020 CPAU adopted an hourly carbon neutral accounting standard. This will ensure that the technologies such as energy storage which can store the lowest carbon hours and then help the grid during the highest carbon hours are properly valued when making investment decisions.

6. Solar Net Energy Metering Rate: Since Palo Alto compensates new solar customers at the value to the utility for the solar exported to the grid, if the value of electricity continues to decline during the day, the value of local solar exported to the grid may decline as well. If the difference between the retail rate of electricity and the value of local solar electricity exported to the grid increases in the future, this will increase the value of local energy storage to customers.

Key Differences in Energy Storage Value between CPAU and PG&E

Since two separate analyses suggest that energy storage is not currently financially beneficial to CPAU and its customers, it is important to understand why it is considered beneficial for the investor-owned utilities (IOUs) which are required to invest in and subsidize energy storage for their customers. Some of the key differences between CPAU and the IOUs such as PG&E which are required to invest in storage systems via the SGIP are shown below.

1. <u>Distribution System Deferral:</u> Lower value for CPAU than PG&E.
    a. *The City's electric distribution system is not currently constrained* since electricity sales are 30% below historical peak due to aggressive efficiency, high customer adoption of solar, departure of industrial loads, lack of other load growth, and lower summertime temperatures.
    b. Staff will continue to investigate specific locations on the residential side of the distribution system for opportunities for distribution deferral, especially in neighborhoods switching to all electric homes and with high penetration of electric vehicles.

2. <u>Back-up Power for Outages & Power Safety Power Shutoff Events:</u> Lower value for CPAU than PG&E.
    a. *CPAU's territory is mostly urban*, non-mountainous terrain, lower fire-risk and fewer distribution miles per customer, therefore limited customers are affected by PSPS. CPAU also has relatively few outages.

3. <u>Time-of-Use (TOU) Rate Bill Management:</u> Lower value for CPAU than PG&E.
    a. *There is no Residential TOU rate* as CPAU does not yet have smart meters installed and therefore cannot distinguish when during the day electricity is being used. Price differentials for TOU pilot rates in Palo Alto have historically been small, though this may have changed marginally in recent years.
        i. CPAU expects to have smart meters deployed by 2024.
        ii. Staff is exploring ways to control smart electric vehicle charging, smart building management systems, and smart thermostats to leverage flexible demand response programs. Connected batteries would be eligible in any pilot.
        iii. TOU rate design will be an important topic in a future electric cost of service study.
    b. The price differential in the current CPAU commercial TOU rate is small.
        i. Staff will be evaluating this in the next electric cost of service study as well.

4. <u>Utility-scale Transmission-Connected Energy Storage:</u> Lower value for CPAU than PG&E.
    a. CPAU owns highly flexible load-following hydroelectricity, which provides ~15% of its electric supply.
    b. CPAU has already entered into long-term contracts for carbon-free resources that will supply ~110% of its electricity needs through 2024. If CPAU were currently contracting for new renewable resources, the economics of bundling in utility scale storage during construction would be more advantageous.

<u>Comparison of Planned Storage Expenditures between CPAU and PG&E Territory</u>

A comparison between CPAU and the surrounding IOU PG&E Self Generation Incentive Program (SGIP) on the basis of authorized budget and on key aspects are below.

<u>Customer-sited storage:</u>

- 87% of the total PG&E SGIP funding dedicated to customer-sited energy storage is reserved for high fire risk customers, those who have had multiple PSPS events in the last two to three years, and or low-income customers. CPAU has very few customers with high fire risk and has relatively few customers who are both low income and have high fire risk.

- A comparison of the remainder of the dedicated SGIP funding[12] shows that:
    - An equivalent pro rata amount of funding dedicated to customer-sited energy storage would be $500k in total for CPAU, which would roughly translate to 220 kW / 590 kWh of customer-sited batteries installed in CPAU territory.
    - As of 2020, Palo Alto already has 240 kW / 648 kWh in residential batteries installed and 1,000 kW / 2,020 kWh commercial customer-sited batteries.
- For customer-sited energy storage, CPAU customers appear to be investments on their own, which could call into question whether utility intervention to further stimulate demand is required in this market.

Large-scale or transmission grid-tied:

- An equivalent amount of funding allocated for transmission/wholesale interconnected storage would be about $1.3M and would roughly translate into 1.1 MW / 4.4 MWh of transmission grid-tied batteries installed.
- Palo Alto is evaluating competitive transmission grid-tied projects in the 5 MW / 20 MWh range.

PUBLIC ENGAGEMENT

Resiliency, lowering costs, and lower carbon emissions are core values of CPAU. CPAU will engage the public as needed on the topic of energy storage in the S/CAP process and as part of any other local discussions on resiliency as they relate to energy storage.

NEXT STEPS

Staff, Utilities Advisory Commission, and Finance Committee recommend that Council make a motion to accept the staff recommendation that CPAU not set any energy storage system targets at this time, and that Council receive the 2020 CPAU Energy Storage Report. Staff is evaluating transmission grid-tied storage located at utility-scale renewables. CPAU will also consider utility scale and behind-the-meter storage as supply portfolio options in the 2024 Electric Integrated Resource Plan. Staff will also continue evaluating specific local projects which due to their location could provide extraordinary resiliency, lower carbon emissions, or distribution system value.

There are six key areas that staff will continue to explore as these will have the highest value to CPAU and its customers:

1. Examine using flexible loads to avoid or minimize future rotating outages: Flexible loads have many of the benefits of energy storage but are much less expensive than purchasing standalone batteries or other energy storage. The recent electricity supply shortages at the state level indicate that flexible electricity loads such as storage, flexible EV charging, flexible building management systems, smart thermostats and smart heat-pump water heaters may currently be undervalued. Staff will be examining ways to use flexible electricity loads to minimize the risk and severity of rotating outages in the future. This could be configured as an Automatic Demand Response program or a Virtual Power Plant. It is important to note that flexible loads like these programs reduce the likelihood and magnitude of future rotating outages, but if Palo Alto is called upon to shed load for the reliability of the statewide grid, CPAU will have to initiate the outages mandated.

2. Examine investing in flexible electrification to create distributed thermal energy storage: Electrification of space and water heating has the potential to decrease carbon emissions even more

[12] This includes funds not already made available, but earmarked for SGIP through authorized collections.

if these systems use electricity during the cleanest hours of the day and coast through the highest emission hours of the day, since heat-pump water heaters and buildings can pre-heat when residents are not home and then maintaining their temperatures with excellent insulation. CPAU is already incentivizing electrification of space and water heating and could add extra incentives to those systems which can be dispatched to follow the cleanest hours on the grid.

3. <u>Evaluate local energy storage at existing local solar for resiliency:</u> Explore partnering with emergency services to add storage to existing local solar sites at City facilities. Storage could be used to mitigate the risk and severity of potential supply shortages in addition to catastrophic emergencies. The combination of solar plus storage may also be able to contribute to resiliency needs in a highly electrified environment, such as would result if the City's Sustainability and Climate Action Plan (S/CAP) goals were achieved.

4. <u>Continue to evaluate competitive proposals for energy storage at utility-scale renewable generation</u>: CPAU is currently evaluating multiple proposals for energy storage sited at utility-scale renewable generation and will move forward with any proposals that are found to be economic and a good fit for the electric supply portfolio.

5. <u>Continue to evaluate financial and physical integration of storage and flexible loads:</u> CPAU is evaluating both the physical impacts of energy storage and flexible loads on utility distribution system operations as well as the costs and benefits to the utility's financial position and other ratepayers. In particular, as the industry evolves, staff will evaluate the impact of storage and flexible loads on cost-of-service rate design and make adjustments if needed.

6. <u>Evaluate the potential resiliency needs of an electrified community (one in which the Sustainability and Climate Action Plan goals are fully implemented) and the role energy storage may need to play:</u> CPAU continues to evaluate current and future resiliency needs, including the potential role of energy storage.

RESOURCE IMPACTS

The pace of the projects outlined above will be dictated by staffing availability. The largest staff and resources impact would be Items 1 and 2 or ramping up Item 3. If the City were to decide to launch pilots, such as an Automatic Demand Response program or locate storage at solar sites, it would likely require at least 0.5 FTE and $100k for the first year, for the evaluation phase alone. Staffing and resources would need to be identified through either a) additional staffing resources or b) a reprioritization of existing staff and resources which would impacting other City priorities. These projects, which could be strategically useful in the long term, would need to be balanced against other utility and council priorities such as Sustainability and Climate Action Plan (S/CAP) implementation and the Advanced Metering Infrastructure (AMI) rollout, both of which will require staff effort and resources. While either Automated Demand Response or battery installations at solar sites could be a part of the utility's supply portfolio in the long term, in the short term the pilots require significant staff effort for limited financial benefit.

Staff currently staffs Item 3 as an ongoing low-level work item. When an opportunity to evaluate energy storage at a City facility arises, the Utilities Department works with other City departments such as the Office of Emergency Services and Public Works to help evaluate City facilities as potential energy storage sites. Staff also works with major facilities in Palo Alto to evaluate partnerships, such as the VMware microgrid pilot partnership. Making Item 3 a more proactive effort to find new solar and storage opportunities, rather than a reactive one in response to opportunities that arise, would require additional staff resources as detailed above. Items 4 through 6 are already being executed with existing staff resources in the next one to two years in response to utility strategic needs and priorities.

POLICY IMPLICATIONS

Energy storage is a key technology to enable increased penetration of renewable energy in California and, when installed in customer premises, reduce their utility use. These two aspects conform to Utilities Strategic Plan objectives and Council policy on environmentally sustainable development.

ENVIRONMENTAL REVIEW

Council acceptance of staff and UAC's recommendation to decline to adopt energy storage system targets under California Assembly Bill (AB) 2514 at this time, and that Council receive the 2020 City of Palo Alto Utilities Energy Storage report, is not a project requiring environmental review for the purpose of the California Environmental Quality Act, because these are administrative activities of government that will not result in direct or indirect physical changes in the environment (Cal. Code Regs. Tit. 14 Sec. 15378(b)(5)).

City of Palo Alto
City Council Staff Report

(ID # 12381)

Report Type: Action Items **Meeting Date: 8/16/2021**

Summary Title: Workplan for November 2022 Local Ballot Measure(s) & Affordable Housing Funding Referral

Title: Approve the Workplan for Development of a Revenue-Generating Local Ballot Measure for the November 2022 General Election; Review and Potential Guidance to Staff on Affordable Housing Funding as Referred by the City Council

From: City Manager

Lead Department: Administrative Services

Recommendation

Staff and the Finance Committee recommend that the City Council approve the workplan for the pursuit of a revenue-generating local ballot measure for the November 2022 General Election with the following focus:

A) The pursuit of a business tax and the preference of square footage as the basis for such a tax;
B) The pursuit of a utility use-based tax;
C) Proceed with the refinement of estimates and evaluation of potential tax measures - including stakeholder outreach, polling and further feasibility analysis - and bring forward the budget actions necessary; and
D) Review and accept additional information regarding affordable housing funding mechanisms.

Summary

On Tuesday June 15, 2021, the Finance Committee reviewed City Manager's Report #12299 (Attachment B of this report) to recommend the City Council approve the workplan for pursuit of a revenue-generating local ballot measure for the November 2022 General Election and review and provide potential guidance to staff on affordable housing funding mechanisms as referred by the City Council.

Through that review, the Finance Committee reached consensus with the recommendation above passing unanimously. The full minutes from the conversation can be found beginning on page three (3) of the summary minutes from the June 15, 2021 meeting. There were several additional questions that the Finance Committee addressed that warrant further discussion with the broader City Council, specifically:

- What revenue level should a business tax target and what should be a metric for measurement/comparison, e.g. tax receipts as percentage of the General Fund?
- Should a utility-use based tax replace revenue previously provided by the Gas and Electric "general fund transfers" or should the tax also incorporate revenue for potential climate adaptability and resiliency work?
- What are the administrative burdens (including employees/FTEs) of imposing, implementing, and collecting a new tax?

Although square footage was identified as the preferred basis for a business tax, other potential options discussed include basing the tax on employee headcount, gross receipts, or payroll. There was not consensus on ranking the other potential options. Attachment A to this report briefly describes each tax, lists neighboring cities using that tax basis, potential data sources to cross-reference against self-reported numbers, and preliminary revenue estimates.

As discussed in CMR #12299, the timeline to bring forward a ballot measure as part of the November 2022 election is relatively short. The Finance Committee recommended that the City Council approve the workplan, which appears in Attachment B, but is detailed again here for ease of reference and discussion with the City Council.

Table 1. Workplan for November 2022 Ballot Measure

SCHEDULE	TASK
JUNE 2021	*Finance Committee:* - *Recommendation to City Council on Workplan for 2022 ballot measure(s)* - *Review and discussion of affordable housing funding and other funding needs in the context of available revenue generating strategies.* Agreement on an approach to the development of revenue estimates and options, workplan, and roles.
JULY 2021	*Staff Work:* Development of Agreements for consultant services (may require RFP or be exempted from City's solicitation requirements). Depending on which potential revenue-generating local ballot measures are pursued, staff will seek consultant expertise including financial analysis, modeling, additional research, stakeholder engagement and polling. No funding is currently allocated for this and staff recommends use of the "Reserve: Strategic Investments" which is currently recommended to have a balance of $750,000 in FY 2022 to fund these services.

SCHEDULE	TASK
AUGUST 2021 – SEPTEMBER 2021	*City Council:* - *Direction to staff on which ballot measures to pursue and allocate resources, as recommended by Finance Committee.* (tentatively to be considered in August 2021) *Finance Committee:* - *Accept initial analysis of revenue generating proposal estimates.* Estimates to be completed internally by staff and intended to assist in informing various working groups in financial planning and focus further refined analysis. *City Council award of consultant contract(s):* as necessary to complete this workplan.
OCTOBER 2021	*Finance Committee:* - *Accept refined analysis of revenue generating proposals.* - *Discuss and provide guidance on initial polling and initial stakeholder outreach*. With the assistance of consultant expertise, a more in-depth review of revenue generating proposals will be presented to the Finance Committee providing more accurate financial estimates to assist in financial planning. *Staff work:* Complete initial outreach to key stakeholders *City Council:* Discuss Councilmember and community leaders and advocates roles
NOVEMBER 2021	*City Council:* - *Confirmation on potential revenue generating proposals including revised revenue estimates* - *Direction to complete initial polling and initial stakeholder outreach.* Work completed with the Finance Committee to be reviewed by the full Council in order to receive input and direction on more refined steps.
DECEMBER 2021	*City Council:* - *Decision on revenue generating proposal(s) to pursue.* Decision to be informed by the Finance Committee, financial analysis, polling results, and a more refined understand of potential projects and associated costs.
DECEMBER 2021 – APRIL 2022	*Staff work:* Continue stakeholder outreach, draft required legal documents, complete polling as appropriate. City Council and Finance Committee will be provided updates as necessary for status check-ins, additional rounds of polling, feedback, and policy decisions.
MAY 2022 – JUNE 2022	*City Council: approval of November 2022 ballot measure and specific measure language.* Should the City Council choose to pursue a ballot measure(s), final approval including the ballot measure language will need to be submitted to the Santa Clara County Registrar of Voters in early August 2022.

Staff resources are insufficient to complete this workplan; consultant resources will be required to augment staff and complete necessary elements of the workplan including polling, stakeholder outreach, and ordinance drafting. Depending on what potential revenue-generating tax(es) the City Council choose to pursue, additional consultant support for analysis may also be required. Staff will return to the City Council for the appropriation of funds and approval of contracts as appropriate. Further discussion on potential revenue-generating local ballot measures, as well as information on corresponding resource impacts and stakeholder engagement can be found in CMR 12299 (Attachment B of this report).

In addition to the timeline and details of potential ballot measures, staff also provided information regarding housing funding options for the committee's review as directed by the City Council. This transmittal is intended to satisfy that referral from the Council and does not require action other than the acceptance of the information for Council consideration as it considers revenue-generating measures.

Conclusion and Next Steps

This report resumes the Finance Committee and City Council's guidance to staff in the pursuit of additional revenue streams to be brought forward for voter approval through the November 2022 general election and provide information regarding affordable housing funding mechanisms. Based on prior discussions with the City Council and the Finance Committee, staff anticipates pursuing a business tax and a utility-use based tax. The City could allocate the funds either towards specific uses or general city services to support City operations, capital infrastructure needs, affordable housing, or other priorities that the City Council agrees upon.

The timeline, resource impact, and stakeholder engagement effort will each be impacted by the decisions of the City Council and the Finance Committee and will scale according to the necessary scope of work. The timeline provided above provides a guide on next steps and a recommended cadence for necessary approvals by the Finance Committee and the City Council to reach the November 2022 ballot.

Attachments:

- **Attachment5.a:** Attachment A: Summary of Business Tax Types
- Attachment5.b: Attachment B: CMR 12299 FInance Committee Discussion of Potential Revenue Generating Local Ballot Measures

Attachment A: Summary of Business Tax Types

This attachment displays a brief summary of the four types of business tax that the Finance Committee requested more information on during the June 15, 2021 discussion. The Finance Committee expressed consensus to pursue a business tax based on square footage but requested additional information pertaining to potential business taxes based on gross receipts, headcount, and payroll. Table 1 of this attachment is meant to serve as a quick reference guide to see the relevant information from prior discussions regarding the development of a potential revenue-generating local ballot measure and address the information requested by the Finance Committee.

Table 1 of this attachment, seen on the next page, shows the tax type, with a brief description of the basis of the tax, lists local cities with a business tax of that type, and briefly discusses the potential data sources that could be used as check-point to verify submissions from firms. The final column shows the potential revenue estimates – it is important to note that the revenue estimates will very likely be revised downward as the City further explores a business tax and defines not only the various tiers for tax rates but also exemptions and exceptions to the business tax.

Attachment A – Summary of Business Tax Types

Table 1. Business Tax Types

	Square Footage	Gross Receipts	Headcount	Payroll
Basis for Tax	Could either be structured as a non- *ad valorem* parcel tax paid directly by landlords through property tax roll or business tax paid by firms to the City	Gross Receipts subject to taxation are defined broadly and include amount charged/ received for the sale of goods of service. Certain exemptions may apply	Typically a graduated tax on companies based on number of employees within City limits	Usually calculated as a percentage of salaries paid to employees
	Certain exemptions may apply to these various bases for tax depending on the underlying tax foundation and restrictions			
Local Cities	• East Palo Alto • Cupertino	• Richmond • Oakland • San Francisco • Walnut Creek • San Mateo • Daly City • Sausalito	• San Jose • Mountain View • Redwood City • Santa Clara • Sunnyvale	• San Francisco phased out their payroll tax; significant difference between CEO pay and employee pay triggers additional Gross Receipts rate
Data-Source Check-Points	• County Property Tax Data • InfoGroup Data • CoStar Data • Auditing	• California Department of Tax and Fee Administration (CDTFA) for those subject to sales tax • Auditing	• Employee Development Department (EDD) data • Auditing	• Employee Development Department (EDD) data • Auditing
Revenue Estimate	• $350 per parcel could yield ~ $7 M • $1 per square foot of rentable building square feet (sf) could generate $25.8 M annually • Cupertino's tiered structure of rentable sf could yield between $1.0 M and $3.2 M	• 2009 structure of gross receipts tax was estimated to yield approximately $4.4 M annually (CMR 156:09)	• $3.6 M (2019 data based on Mt View Rates as noted in CMR 10445)	• $15.5 M- $16.5 M (2019 data using 0.1% of payroll as noted in CMR 10445)

City of Palo Alto (ID # 12299)

Finance Committee Staff Report

Report Type: Action Items **Meeting Date: 6/15/2021**

Summary Title: Workplan for November 2022 Local Ballot Measure(s) & Affordable Housing Funding Referral

Title: Recommend the City Council Approve the Workplan for Pursuit of a Revenue-Generating Local Ballot Measure for the November 2022 General Election; Review and Potential Guidance to Staff on Affordable Housing Funding as Referred by the Council

From: City Manager

Lead Department: Administrative Services

Recommendation

Staff recommends that the Finance Committee recommend to the City Council approval of the workplan for pursuit of a November 2022 or other local ballot measure(s) and any additional guidance including but not limited to:

A) Affirming pursuit of a business tax, and refinement of the basis for such a tax (e.g. headcount, payroll, square footage, gross receipts, or other);
B) Affirming pursuit of a utility use-based tax;
C) Direction to proceed with refinement of estimates and evaluation of potential tax measures, including stakeholder outreach, polling and further feasibility analysis; and
D) Review of additional information regarding affordable housing funding as directed by the City Council.

Executive Summary

This report resumes the work that the staff and City Council placed on pause in March 2020 with the onset of the COVID-19 pandemic and resumes review of this as outlined as part of the Community and Economic Recovery workplan and Council priority in 2021. Throughout the past decade, the City has worked to structurally balance its long-term revenues against increasing expenses. In 2019, the City Council adopted fiscal sustainability as an annual priority and approved a workplan on that priority through CMR 10267.

As an element of the fiscal sustainability workplan, through iterative conversations with the Finance Committee and the City Council, significant work was done on developing potential business tax ballot measure. This report seeks to resume the City's work effort to identify a

potential revenue-generating local ballot measure(s) and to finalize a workplan and potentially narrow the scope for staff to focus limited resources on reaching the general election scheduled in November 2022. The report includes key attachments for the Finance Committee's review and reference:

- The earlier work on this topic included an analysis of potential options for raising revenue and a summary of that work is included with this report as **Attachment A.**
- A summary of funding options for Affordable Housing is included with this report as **Attachment B.**
- A summary of prior work specifically related to the development of a potential business tax is included as **Attachment .C**
- A full list of prior CMRs on fiscal sustainability and the topic of a revenue generating local ballot measure is included with this report as **Attachment D.**

In addition to review of the past and current work, staff has provided a workplan/timeline to complete this priority with the target of consideration of a measure(s) on the November 2022 election. Consistent with past practice, staff recommends the Finance Committee will serve as the main deliberative body for the development of a potential revenue-generating local ballot measure and that updates will be taken to the City Council for review and ultimately direction to staff in addition to the appropriation of resources.

Background

The City of Palo Alto has worked towards fiscal sustainability over the past decade through a number of actions, specifically outlined in the Fiscal Sustainability Workplan of 2019. These actions included proactive funding contributions for the city's long-term liabilities for both pension and Other Post-Employment Benefits (OPEB) and strategies to structurally balance the General Fund's revenue and expenditures on an ongoing basis. This work is detailed more fully through CMR 10267 which details each of the 14 elements of the workplan to address the 2019 City Council priority of Fiscal Sustainability and CMR 11722 which adopted the City's proactive pension funding policy.

Despite this work, structurally balancing revenues and expenses on an annual basis has proven difficult. The City Council has articulated numerous needs beyond current funding levels including:

- Funding for Affordable Housing
- Funding for electrification and Climate Change Resilience and Adaptation
- Funding for Capital Needs (including but not limited to railroad grade separation alternatives)
- Funding for Delivery of Core Services – i.e. Parks, Youth Services, Community Services, Libraries, Fire and Emergency Medical Services, and Police

The economic impacts associated with the COVID-19 pandemic, and efforts to contain and mitigate the spread of the virus resulted in a $40 million gap between revenues and expenses in the FY 2021 Adopted Operating Budget, which was balanced through significant reductions in departmental operating expenses throughout the organization, significant reduction in capital investment including catch-up and keep-up costs as well as new projects, and concessions from some of the City's bargaining units.

The table below shows the amount of general fund revenues from FY 2019 through FY 2022 in the major categories. The precipitous decline seen at the end of FY 2020 continued through FY 2021 as reflected in the FY 2021 estimate column.

Table 1. Summary of General Fund Revenues: FY 2019 and FY 2020 Actuals, FY 2021 Estimate and FY 2022 Proposed

	FY 2019 – Actual	**FY 2020 – Actual**	**FY 2021 – Estimate***	**FY 2022 Proposed**
Property Tax	$47.3	$51.1	$53.17	$51.2
Sales Tax	36.5	30.6	25.03	28.2
Transient Occupancy Tax	25.6	18.6	4.8	8.4
Utility Users' Tax	16.4	16.1	14.1	14.4
Documentary Transfer Tax	6.9	6.9	6.9	7.1
Charges for Services & Licenses and Permits	35.8	31.6	29.5	32.5
All Other Revenues	57.3	54.8	55.4	63.8**
Total General Fund Revenues	**$225.8 M**	**$209.7 M**	**$188.9 M**	**$205.6 M**

* This reflects the FY 2021 estimate as shared with the Finance Committee at the outset of the budget development process; staff subsequently communicated to the Finance Committee and the City Council that it anticipated slightly higher levels at year-end depending on activity levels in certain revenue streams.
**The FY 2022 Proposed Estimate for other revenue did not include the 60/40 Split of American Recovery Plan Act (ARPA) funding, nor the final allocation of that funding. Subsequent to the issuance of the proposed budget, all other revenues have increased to $65.8 million bringing total FY 2022 Proposed Revenues to a total of $207.6 million.

As seen in Table 1, sales tax and transient occupancy tax revenues and their contributions to the General Fund were a strength in FY 2019 that helped fund the myriad of services in Palo Alto that differentiate it from other jurisdictions. Unfortunately, primarily as a result of the economic impact of efforts to contain and mitigate the spread of COVID-19, these revenues contracted and declined.

Adding to revenue challenges, in FY 2021 a local court held that a portion of the City's longstanding annual transfer of funds from the gas and electric utilities – which has funded general City services such as police, fire, parks and libraries for many decades – could not lawfully continue absent voter approval. While the court ruling is not final and may be appealed, for FY 2022 the City has prudently set aside the disputed funds in a reserve pending resolution of the issue. On the November 2022 ballot, the City could seek voter approval to confirm the longstanding transfer or could seek to replace the transfer revenues with an increase in the utility user tax or some other type of tax.[i]

The current FY 2022 Operating Budget adjusts for both the current impacts of the pending litigation as well as the recovery period due to the current pandemic and relies on one-time funding to bridge the current uncertainties and delay further service reductions beyond those approved as part of the FY 2021 Adopted Budget. However, the significant reductions taken in FY 2021 will persist on an ongoing basis unless revenues can be brought into alignment with expenses. This report represents the next step in discussions with the Finance Committee and the City Council to address structural financial needs and is the first step in resuming prior discussions regarding a business tax and potentially a utility use-based tax and how they can be brought forward for voter consideration as part of the November 2022 general election.

Discussion

As discussed in CMR 10392 charter cities have two primary mechanisms for generating revenue: 1) charging for services and 2) taxes. More information on these mechanisms, a brief summary of Palo Alto's major existing tax categories, and the potential impacts associated with pursuing changes to various tax rates are explored in greater detail in **Attachment A** of this report. Potential revenue estimates are meant to offer context at this early stage to inform the conversation with the Finance Committee and guide potential next steps. Consistent with the discussions associated with a potential business tax through FY 2019 and FY 2020, it is anticipated that these estimates are maximums and are likely to be refined downward through additional variables, exemptions, changes to the eligible bases, and other considerations as they are more fully developed.

Prior to COVID-19, the City undertook a significant work effort to discuss potential revenue generating ballot measures. Links to each of the City Manager Reports associated with the prior work effort are included in **Attachment D**. Through those discussions, staff presented a discussion of the various taxes that contribute to the General Fund and proposed using Equity, Administrability, Stability and Economic Benefits (EASE) as the framework for analysis. The EASE framework is discussed further in **Attachment A.**

Previous work on local ballot measures included three parallel paths that were pursued by staff, augmented by consultant resources, and a fourth path that was not reached during the prior effort. Staff recommends that the Committee and Council continue to use this framework as the organization resumes this work. These four paths, the consultants used, and the contractual authority were:

- Research, Analysis, and Modeling – Matrix Associates - $75,000
- Stakeholder Outreach – TBWB - $94,125
- Polling – FM3 Associates - $85,000
- Drafting Ordinance Language – N/A

The City suspended consideration of a ballot measure before the fourth element of drafting an ordinance got underway. Regardless of which local ballot measures are pursued further to place on the November 2022 ballot, it is likely that the work will once again be organized into these three focus areas and that the City Attorneys' Office will retain outside counsel to assist with drafting the ordinance language to enact the measure. More discussion of these paths is included in **Attachment C.**

In addition, staff has provided detailed information regarding affordable housing funding as referred to staff and the Finance Committee in the Housing Workplan. **Attachment B** provides a summary of funding strategies for affordable housing initiatives. Overall, staff has found that a combination of financial/funding strategies and partnerships is the most common framework for a successful affordable housing project. As noted above, the Council has identified a number of financial needs, therefore staff has included this Council referral as part of the discussion of potential local ballot measure(s) to provide the full context of potential expenses to be coupled with potential sources to fund them.

In order to reach the November 2022 ballot, a proposed workplan is detailed here for discussion and refinement with the Finance Committee and the City Council, including their respective engagement roles. It is important to narrow the scope of work as quickly as possible not only to focus limited staff resources and optimize the use of consultants but also to avoid placing too many measures on the ballot.

Governance:
To meet that timeline, staff recommends that the Finance Committee serve as the working body to assist in the review of potential revenue-generating local ballot measures for the November 2022 election and to review staff and consultant work as well as stakeholder feedback. The Finance Committee could then make its recommendations for consideration and action to the full seven-member City Council.

<u>Finance Committee:</u> would serve as the public body to review periodic progress reports, allowing for structured public discussion and the provision of feedback and recommendations on the review and development of a potential revenue-generating local ballot measure. Staff will manage, review, and synthesize work done in-house and by external consultants and incorporate stakeholder feedback into regular progress reports to the Finance Committee. Ultimately, the Finance Committee would recommend their preferred potential revenue-generating local ballot measure(s) to the City Council for further action.

<u>City Council:</u> would serve as the governing body for policy direction at key decision points. This includes direction to conduct polling, approval of alternatives to be evaluated, and decisions on what should be placed on the November 2022 ballot.

Timeline

Given the constrained timeline and resources for pursuing the placement of a ballot measure(s) on the November 2022 ballot, the aforementioned approach once again seems worth pursuing. The table below shows the aggressive timeline necessary to finalize ballot measure language and draft a potential ordinance by late Spring 2022 in order to reach the November 2022 ballot.

SCHEDULE	TASK
JUNE 2021	<u>*Finance Committee:*</u> - *Recommendation to City Council on Workplan for 2022 ballot measure(s)* - *Review and discussion of affordable housing funding and other funding needs in the context of available revenue generating strategies.* Agreement on an approach to the development of revenue estimates and options, workplan, and roles.
JULY 2021	<u>*Staff Work:*</u> Development of Agreements for consultant services (may require RFP or sole source exemption). Depending on which potential revenue-generating local ballot measures are pursued, staff will seek consultant expertise including financial analysis, modeling, additional research, stakeholder engagement and polling. No funding is currently allocated for this and staff recommends use of the "Reserve: Strategic Investments" which is currently recommended to have a balance of $750,000 in FY 2022 to fund these services.
AUGUST 2021 – SEPTEMBER 2021	<u>*City Council:*</u> - *Direction to staff on which ballot measures to pursue and allocate resources, as recommended by Finance Committee.* (tentatively to be considered in August 2021) <u>*Finance Committee:*</u> - *accept initial analysis of revenue generating proposal estimates.* Estimates to be completed internally by staff and intended to assist in informing various working groups in financial planning and focus further refined analysis. <u>*City Council award of consultant contract(s):*</u> as necessary to complete this workplan.
OCTOBER 2021	<u>*Finance Committee:*</u> - *Accept refined analysis of revenue generating proposals estimates;* - *discuss and provide guidance on initial polling and initial stakeholder outreach*. With the assistance of consultant expertise, a more in-depth review of revenue generating proposals will be presented to the Finance Committee providing more accurate financial estimates to assist in financial planning.

	Staff work: Complete initial outreach to key stakeholders *City Council:* Discuss Councilmember and community leaders and advocates roles
NOVEMBER 2021	*City Council:* - *confirmation on potential revenue generating proposals including revised revenue estimates* - *Direction to complete initial polling and initial stakeholder outreach.* Work completed with the Finance Committee to be reviewed by the full Council in order to receive input and direction on more refined steps.
DECEMBER 2021	*City Council:* - *decision on revenue generating proposal(s) to pursue.* Decision to be informed by the Finance Committee, financial analysis, polling results, and a more refined understand of potential projects and associated costs.
DECEMBER 2021 – APRIL 2022	*Staff work:* Continue stakeholder outreach, draft required legal documents, complete polling as appropriate. City Council and Finance Committee will be provided updates as necessary for status check-ins, additional rounds of polling, feedback, and policy decisions.
MAY 2022 – JUNE 2022	*City Council: approval of November 2022 ballot measure and specific measure language.* Should the City Council choose to pursue a ballot measure(s), final approval including the ballot measure language will need to be submitted to the Santa Clara County Registrar of Voters in early August 2020.

Resource Impact

Implementation of this workplan to develop revenue-generating local ballot measures will require significant resources, including internal staffing and consultant expertise as well as extensive stakeholder engagement. Depending on which ballot measure(s) the Finance Committee and the City Council direct staff to pursue, the resource needs will scale proportionately. It is important that the scope of potential ballot measures be narrowed to effectively deploy necessary resources and stay on the timeline as noted above.

To the extent that consultants are required to augment staff on topics such as research, modeling and analysis, polling, stakeholder outreach, and eventually the drafting of ballot measure and ordinance language, staff will return to the City Council for appropriation of funds and approval of contracts as appropriate. For reference, the prior single initiative was directly resourced by approximately the equivalent of 2.0 full-time dedicated staff, significant support from staff stakeholders in key departments, and consultant services support of $250,000 (until the pausing of the work). Staff have gone through resource reductions and therefore expect there will be impacts to other projects, and additional funding needed in excess of the amount used previously, consistent with the work completed in 2019 and 2020. As the Council may choose a variety of measures for analysis and consideration, funding and staff resources will increase accordingly.

Stakeholder Engagement
Staff has solicited input and feedback at multiple junctures through evaluation of a potential business tax through previous conversations with the Finance Committee, the City Council, residents, and the business community. As the scope of this work is refined, staff will work to develop a corresponding stakeholder engagement plan specifically for this effort and incorporate that into the ongoing process. Staff will include stakeholder engagement and feedback as an element of any potential revenue-generating local ballot measure workplan and will regularly report on the status of those efforts.

Conclusion and Next Steps
This report restarts the Finance Committee and the City Council guidance to staff in the pursuit of additional revenue streams to be brought forward for voter approval through the November 2022 general election. Based on prior discussions with the City Council and the Finance Committee, staff anticipates pursuing a business tax and a potential utility use-based tax. Depending on the revenue stream, the City could allocate the funds either towards specific uses or general city services to support City services, capital infrastructure needs, funding affordable housing, or other priorities per City Council direction.

The timeline, resource impact and stakeholder engagement effort will each be impacted by the decisions of the Finance Committee and the City Council and will scale according to the necessary scope of work. In order to meet the timeline to place a ballot measure on the November 2022 ballot, timeline noted above provides a guide on next steps and cadence for approvals needed by the Finance Committee and City Council.

Attachments:
- Attachment A: Options for Raising Local Revenue
- Attachment B: Summary of Affordable Housing Funding Options
- Attachment C: Overview of Prior Work on a Potential Business Tax
- Attachment D: List of Prior City Manager's Reports on Local Ballot Measure

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[i] Green v. City of Palo Alto (Santa Clara Superior Court, Case No. 1-16-CV-300760), a class action lawsuit, was filed on October 6, 2016. Plaintiffs claim that the City's gas and electric rates are taxes that exceed the cost of providing service, absent voter approval, because the rates fund annual transfers from the utilities to the City's general fund. The lawsuit seeks a refund of three years of alleged overpayments by gas and electric ratepayers and an injunction prohibiting further overpayments.

On October 27, 2020, the Santa Clara County Superior Court issued a "Statement of Decision Regarding Phase II Trial" granting the relief sought by the plaintiffs as to the City's gas ratepayers only. The court's ruling established the City's liability at $12.6 million, which the City may have to refund to gas customers after the judgment is final and all appeals, if any are filed, are resolved. Once a judgment is issued by the Superior Court, which is likely to occur during the summer of 2021, both the City and the plaintiffs may appeal. A decision by the City Council whether to appeal is likely to be made after the Council's summer break. If either the City or the plaintiffs appeal, a decision by the Court of Appeal is not expected until late 2022 or early 2023.

Because important areas of law are unsettled relevant to the City's positions on appeal, the exact exposure to the City's general fund cannot be determined with certainty at this time. In the FY 2022 budget, the City has set aside funding to cover the $12.6 million remedy the Superior

Court identified in Phase II, plus interest, as well as the estimated future reduction in the gas equity transfer, should the current Santa Clara County Superior Court decision stand. The City estimates the annual financial impact would be $8 million over the coming four years (FY 2022 – FY 2025 and an average of $4 million annually after the initial four-year period beginning FY 2026).

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Options for Raising Local Revenue

This attachment includes information previously presented to the City Council through City Manager's Reports (CMRs) 10392 and CMR 10445, describing the City's main revenue streams and the impact of changes to those streams, as well as information regarding the potential issuance of a General Obligation (GO) bond or the imposition of a parcel tax. It also includes a brief discussion of potential changes to the basis for the Utility Users Tax. Information related to a potential business tax can be found in **Attachment B**.

As discussed in City Manager's Report (CMR) 10392, cities have two main mechanisms for raising revenues: 1) taxes and 2) fees for services. The City of Palo Alto has a Municipal Fee Schedule which it reviews annually as part of the budget process for a robust span of fees and charges. The City also has service agreements with neighboring jurisdictions for services rendered, ranging from the regional water quality control plant to the provision of fire protection and communication services to Stanford. These fees for services are governed by various state laws and contractual agreements. In some cases, fees are designed to fully cover our cost of providing services. In other cases, fees are designed to pay part of the cost of providing services, with the balance provided by tax revenues. Finally, some fees and charges lawfully exceed our costs, providing excess revenues to help fund other programs and services to residents.

Cities can also impose taxes; however adoption of, or changes to, those taxes must be approved by the voters in accordance with California law, including Propositions 218 and 26. For a general tax, a simple majority of votes cast (50% + 1 vote) is required for approval, while for a specific tax a 2/3 supermajority approval is required. By state law, cities may place a general tax before the voters only at a general municipal election, which is an election that includes open seats on the governing body. (The exception to this rule is a fiscal emergency declared unanimously by the governing body).

Tax Revenues

Property Taxes

Property taxes are the largest revenue generator for the City of Palo Alto. All taxable real and personal property is subject to a 1% basic tax of assessed value collected by local jurisdictions and school districts for general service purposes. The City of Palo Alto receives only 9.42% of the assessment, with the majority (45.61%) going to Palo Alto Unified, followed by Santa Clara County (15.93%) and ERAF (13.88%). Due to Proposition 13, the effective property tax rate is only 0.49% of assessed value – less than half of the 1% basic tax.

Potential Property Tax Rate Change

Property taxes are regulated by state laws, including voter-approved constitutional provisions such as Proposition 13. Changing the rate itself is not within a municipality's authority. However, cities can use mechanisms such as parcel taxes which are levies on parcels of property. Typically,

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these are set at some fixed amount per parcel and cannot be based on the value of a property. These levies can be based on lot square footage and or land use designation. Parcel taxes are usually special taxes requiring a 2/3 voter approval. Parcel taxes are levied on the property owner; however, property owners may pass on these costs to their tenants in the form of increased rent or more expensive leases.

Sales and Use Tax

Sales and Use Taxes are usually the second largest revenue generator for the City of Palo Alto, raising $30.6 million in General Fund revenue in FY2020. Sales Tax rates include state, regional, and local assessments. Currently, the City of Palo Alto has a tax rate of 9.0 percent. The City receives 1% point of the purchase, or 11.1% of each tax dollar. The remaining distribution is State of California (5.75% point), Santa Clara County (0.125% point), Santa Clara Valley Transportation District (1.625% point) and Public Safety Fund (0.5% point). As seen in Table 1 of CMR 12299, Sales Tax revenues can fluctuate significantly depending on the overall state of the economy.

Potential Sales Tax Rate Change

An increase in the Sales Tax rate of ¼ cent, or 0.25 percentage points, as a district tax, would generate approximately $4.5 million in additional revenue annually. The State of California caps local sales taxes levied by local jurisdictions at 3.0%, meaning the total percentage can be no greater than 10.25%. This tax would be equitable across businesses of the same industry, however, it does not apply to industries that are not subject to sales tax. Sales tax is widely considered to be an outdated tax structure and according to the City's consultants only applies to up to 40 percent of the economic base. This structure and the driver for it, disposable income being a significant portion this tax, is subject to economic fluctuations as well as longer term fluctuations and the consumption of goods changes in society.

Transient Occupancy Tax

Prior to COVID-19, Transient Occupancy Tax (TOT) was the third largest tax revenue generator for the City of Palo Alto, generating $18.6 million in revenue in FY 2020, down from $25.6 million in FY2019. The Palo Alto rate of 15.5% is applied to the daily rate charged by a hotel, motel, or other lodging establishment. In November 2018, Measure E was passed raising the rate from 12% to the current level of 15.5%. TOT revenues have sharply declined due to the shelter in place declared due to COVID-19.

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Potential Transient Occupancy Tax Rate Change
An increase in the TOT rate would primarily impact the visitor population. A 0.5 percentage point increase in the rate from 15.5 percent to 16 percent would generate approximately $900,000 in additional revenue annually.

Utility Users Tax

Utility Users Tax generated the next largest revenue, with receipts of $16.1 million in FY20, down from $16.4 million in FY19. The Utility Users Tax is charged to all users of electricity, gas, water and telephone services. This tax is based on consumption by each respective utility. The revenue decline was due to lower consumption of both utility commodity and telephone caused by COVID-19. The electric utility revenues are comprised of approximately 70-75 percent commercial usage and 25-30 percent residential. The gas utility revenues reflect approximately 45-50 percent commercial usage and 50-55 percent residential usage. Water utility revenues are approximately 30-35 percent commercial and 65-70 percent residential. The current rate for electricity, gas and water is 5.0% and for telephone is 4.75%.

Potential Tax Rate Change

A 1 percentage point increase in the current UUT rates, bringing the electricity, gas, and water rate from 5 percent to 6 percent, and increasing the telephone rate from 4.8 percent to 5.8 percent, would generate an estimated $2.3 million in additional revenues annually. As a consumption-based tax, high volume customers bear more of the cost.

Potential On-Bill Tax for Gas and Electric Services

As noted in the staff report, the City is currently in litigation over the longstanding practice of transferring a portion of revenues from gas and electric charges, according to a formula, to the general fund to support City services such as police, fire, libraries and parks. In FY 2020, the Gas Fund transferred $6.9 million to the General Fund and the Electric Fund transferred $13.1 million to the General Fund. Of these, approximately 65% of the Gas Fund Transfer was from commercial customers, while 82% of the Electric Fund transfer was from commercial customers. No final judgment has been entered and litigation is ongoing, however, the Superior Court has entered an order upholding the electric transfer but determining that a portion of the gas transfer is unlawful absent voter approval. To resolve all legal questions about the transfers, the City could seek voter approval for the transfers in November 2022.

One form that a voter-approved equity transfer could take would be a percentage charge on gas and electric utility bills that could be used to fund general city services. The exact percentage and the amounts expected to be raised could be analyzed, discussed, and potentially tiered by volume. This could be structured as an increase to the Utility User's Tax for gas and electric, or as a separate line item tax on gas and electric services to replicate the longstanding equity transfer. Depending on the rate and structure, the tax could be cost-neutral to rate payers. In other words, rather than incorporating the , thereby lowering the initial rates, and then would be offset by a corresponding increase to the Utility Users' Tax rates.

Documentary Transfer Tax

Documentary Transfer Taxes generated $6.9 million in revenue for the City of Palo Alto in FY2019 and FY 2020, ranging from $3.1 million in FY 2009 to a high of $10.1 million in FY 2015. This tax is applied to the sale of real property within Palo Alto as property ownership is transferred. The State of California has a standard base rate of $1.10 per $1,000 of sale price, of which the City and County split the proceeds 50/50 which applies to general law cities. As a charter city, the City of Palo Alto has more discretion to set its rate. The City of Palo Alto currently has a non-conforming rate, meaning that it varies from the State's standard rate, currently set at $3.30 per $1,000 of sale price.

Potential Tax Rate Change

Property owners who sell their property would be impacted by an increase in the rate and would pay this tax once per sale of a parcel. Assuming approximately $9 million in annual proceeds, a $1.10 increase in the rate to $4.40 per $1,000 of the sale price would result in additional revenue of approximately $2.8 million.

Other Revenue-Generating Options – Parcel Tax and General Obligation (GO) Bond

Parcel Tax

The City could choose to pursue the placement of a parcel tax on the November 22 ballot, either as a general parcel tax or one specific to businesses. CMR 10445 detailed further information on Parcel Taxes and their potential applicability. That information is repeated here for ease of access.

In California, local agencies (e.g. city, school and community college district, etc.) are authorized to impose parcel taxes which require a two-third supermajority vote approval for specified purposes. For cities, parcel taxes are subject to limitations under Government Code Section 50075 et seq.

Recent decisions of the California Supreme Court and Courts of Appeal have held that voter initiatives are not subject to certain procedural requirements that apply to tax measures placed on the ballot by local governments, including the timing of elections (general municipal election or any election) and supermajority approval requirements. This area of the law is continuing to evolve. More information can be provided as needed.

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Parcel taxes are levied on a property owner's property tax bill and may be a specific amount (that may escalate) or it can be based on a factor such as building square footage. The most common type of parcel tax is a fixed amount, identical for all parcels regardless of use, size, or value, and often includes a sunset provision. Per California Article XIIIA, Section 4, special taxes (like parcel taxes) cannot be *ad valorem* (based on the value of property). A parcel tax can be approved for a set period (e.g., 10 years) or it can be permanent.

> *Fixed amount parcel taxes* if applied to all property owners equally typically require owners of smaller or lower valued property to pay the same amount as owners of larger or higher valued property and therefore are referred to as regressive. A fixed parcel tax is different from an ad valorem property tax, in that it is imposed on a per-parcel basis and is not based on the AV of the property.
>
> *A parcel tax based on square footage* if applied to all property owners would be more equitable on the properties that it applies to (also referred to as "progressive") since it would require owners of properties to pay proportionally based on the size of the parcel. However, this structure would most likely result in a more complex administration of the tax. As discussed in prior reports, in November 2018 the City of East Palo Alto passed a parcel tax based on square footage ($2.50 per square foot) that only applies to commercial office space that is over 25,000 square feet. This limits the scope of impacted parcels that meet these criteria, thereby theoretically limiting both the complexity of administration and the revenue generated through the tax.

In general, properties exempt from the general 1 percent ad valorem (property) tax are exempt from parcel taxes. In addition, there is a separate statute in the Government Code for school district parcel taxes (Gov. Code Section 50079 et seq.) and it differs from the more general parcel tax authority in Section 50075 et seq in two important ways: (1) School districts require a tax that applies uniformly to all taxpayers and (2) they are specifically allowed certain exemptions:

1. Persons who are 65 years of age or older.
2. Persons receiving Supplemental Security Income for a disability, regardless of age.
3. Persons receiving Social Security Disability Insurance benefits, regardless of age, whose yearly income does not exceed 250 percent of the 2012 federal poverty guidelines issued by the United States Department of Health and Human Services.

Though the above exemptions do not apply to city parcel taxes, it may be possible to include specific exemptions like these to the extent it is concluded that the exemption is reasonable based on the purposes of the tax. Further research would be necessary on this based on specific exemptions that Council and/or staff are interested in exploring.

The following table shows the City's property breakdown by land use as of 2018. For example, based on the following data, a fixed $350 parcel tax on 20,087 parcels that are eligible to be taxed would generate approximately $7 million in annual revenue. Potential revenue from an alternative methodology, such as a tax measure based on commercial square footage is described below.

TABLE A-1: Property by Land Use

Property by Land Use
Estimated Revenues Based on Fixed Tax Rate of $350 Per Taxable Parcel

	# Parcels	% of Parcels	FY 2018 Assessed Value (AV)	% by AV	Parcel Tax Revenue
Properties Subject to Parcel Tax					
Agricultural	26	0.1%	$ 15,136,270	0.05%	$ 9,100
Commercial	405	1.9%	1,875,346,761	5.8%	141,750
Manufacturing	55	0.3%	669,193,035	2.1%	19,250
Professional	550	2.6%	5,011,938,010	15.5%	192,500
Industrial	111	0.5%	1,162,901,625	3.6%	38,850
Sub-total - Commercial	1,147	5.4%	$ 8,734,515,701	26.9%	$ 401,450
Residential	18,940	89.9%	23,319,460,730	71.9%	6,629,000
Sub-total - Properties Subject to Parcel Tax	**20,087**		**32,053,976,431**	98.8%	**$ 7,030,450**
Properties Exempt From Parcel Tax					
Forest	23	0.1%	17,527,823	0.1%	n/a
Institutions (e.g. schools, hospitals, etc.)	75	0.4%	69,911,145	0.2%	n/a
Public (gov't, cemeteries, mortuaries, etc.)	363	1.7%	50,962,757	0.2%	n/a
Recreational (parks, playfields, etc.)	15	0.1%	45,587,009	0.1%	n/a
Social (churches, clubs, etc.)	54	0.3%	4,522,615	0.0%	n/a
Transportation (utly, bus, truck, streets, etc.)	18	0.1%	7,539,575	0.0%	n/a
Other (vacant, public, non-profits, etc.)	436	2.1%	178,266,617	0.5%	n/a
Sub-total - Not Subject to Parcel Tax	984	4.7%	374,317,541	1.2%	n/a
Grand Total	**21,071**		**$ 32,428,293,972**	**100.0%**	n/a

A parcel tax measure based on commercial square footage can have a simple structure like East Palo Alto's and/or a more complex tax structure based on types of properties (e.g. office, retail, industrial, etc.). The following table shows potential annual revenues, by property type, based on a $1 rentable building area per square feet parcel tax using CoStar Data. It is not intended to suggest nor provide a structure for a parcel tax. Based on the Committee's feedback and/or direction, staff can return with specific tax structure(s) and their potential revenues.

TABLE A-2: POTENTIAL PARCEL TAX REVENUES BASED ON RENTABLE BUILDING SQUARE FEET ($1 PER SQUARE FOOT)

PROPERTY TYPE	Rentable Bldg. Area (Square Feet)	Estimated Annual Revenue ($)
HOSPITALITY	1,366,278	$1,366,278
INDUSTRIAL	2,453,992	$2,453,992
OFFICE	13,304,877	$13,304,877
RETAIL	4,010,544	$4,010,544
FLEX BUILDING	4,640,212	$4,640,212
GRAND TOTAL	**25,775,903**	**$25,775,903**
EXCLUDES: GOVERNMENT, SCHOOL, PARKING GARAGE/LOT, RELIGIOUS FACILITY, LODGING/MEETING HALL, SELF-STORAGE, CONTRACTOR STORAGE YARD, CAR WASH, SHELTER, AND THEATER/CONCERT HALL.		

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Compared to GO Bond Measures, in the June and November 2018 elections, the approval for City parcel tax measures was slighter better, with 75 percent passing in June 2018 and 83.3 percent passing in November 2018. In June and November 2018, there were 62 parcel tax measures with 34, or 54.8 percent, passing. For City only tax measures, 81.3 percent passed. In addition, of the 13 school parcel taxes 10, or 76.9 percent, passed. As for the sunset provision for parcel tax measures in the last three elections, most school ballot measures had them while, in a given election year, only a third to less than half of non-school measures had them.

TABLE A-3: PARCEL TAX VARIABLES & E.A.S.E.

	PARCEL COUNT	SQUARE FOOTAGE
EQUITY	For fixed (per parcel tax), results in owners of smaller or lower valued property to pay the same amount as owners of larger or higher valued property.	A rentable building square feet tax aligns the tax with both the size and potentially the property types it's assessed on which would be considered more progressive.
ADMINISTRATION	Further research is needed to understand the full administration cost for a parcel tax. What is known are as follows: (1) the University Avenue parking assessment bonds are consider a parcel tax for which the County of Santa Clara's administrative cost is 1 percent of the levy; (2) depending on the tax structure, the county might have a $16 per parcel cost which is far more expensive than the 1 percent of levy fee; staff is working with the county to understand when this is applicable. There likely will be an annual consultant cost to prepare and submit the parcel tax assessment to the county. If these revenues are used to issue bonds, then there will be costs associated with a bond's issuance and on-going management similar to the GO Bond issuance.	
STABILITY	Very stable with low volatility.	Very stable with low volatility.
ECONOMIC BENEFITS	Economic development implications of a flat, parcel tax would depend on any policy choices for exemptions. However, as noted in the discussion a flat tax would be regressive as it does not scale to size or another unit not scale to size or another of measure.	This method could be tailored to promote certain economic development objectives; however, the selected exemptions or varying tax rate scales could result in unanticipated complexities that would make the tax difficult to administrate.

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General Obligation (GO) Bond

Other options that were previously discussed included the issuance of General Obligation bonds. These were also further discussed in CMR 10445 and that information is repeated here for ease of access.

A common form of long-term capital project financing is the General Obligation (GO) bond. Cities can only issue GO bonds to pay for the acquisition and improvement of real property (California Constitution Article XIIIA). Under Article XIIIC of the State Constitution, City GO bonds require a favorable two-thirds supermajority vote of the registered voters that vote on the measure. For California cities, GO bonds are secured by a promise to levy *ad valorem* property taxes (property taxes based on the value of the property) in an unlimited amount as necessary to pay debt service. Voters approve the maximum amount of debt (bonds) that can be issued. The *ad valorem* taxes levied to pay debt service on city GO bonds are in addition to the 1 percent general *ad valorem* property tax. Although the California Constitution was modified in 2000 through the enactment of Proposition 39 to allow schools, community colleges, and county education offices, under defined circumstances, to have a 55 percent popular vote threshold, City GO bonds still require a two-thirds favorable vote.

Generally, based on assessed values (AV), approximately two-thirds or more of a GO Bond assessment is paid by residential parcels and one-third by businesses/commercial parcels in the City of Palo Alto. While GO bonds can be issued for different lengths of time, the most common are 30-year bonds with 40 years being the maximum maturity duration. The City of Palo Alto has issued GO bonds for library and school infrastructure improvements. The City's net library bond issuance of $71 million currently adds $10.62 per $100,000 in AV to each property owner's tax bill, or about $106 per year for a residence appraised at $1,000,000. This is based on a FY 2020 secured property tax AV of $37.3 billion and unsecured property tax AV of $1.9 billion.

The below table reflects a range of potential GO bond issuance size, an initial assessment rate for $1 million in AV for residential/commercial properties and the unsecured property taxes and potential annual debt service payments. The term "unsecured" refers to business personal property that can be relocated and is not real estate (e.g. aircraft, boat and machinery and equipment, etc.).

TABLE A-4: POTENTIAL GO BOND ISSUANCE AMOUNT

POTENTIAL GO BOND ISSUANCE AMOUNT	Residential/Commercial (Rate for $1 M in Assessed Value/Yr)	Unsecured Property (Rate for $1 M in Assessed Value/Yr)	Estimated Annual Debt Service
$100M	$178	$203	$6.6 million
$200M	$356	$406	$13.2 million
$300M	$533	$608	$19.8 million
$500M	$888	$1,012	$32.9 million

Note: the above tax rates will be re-calculated annually based on the annual debt service and the City's total AV. Historically, the AV increases annually while the debt service remains stable resulting in the GO Bonds' tax rates declining.

The below table addresses the E.A.S.E. framework as applied to the analysis of a potential GO Bond issuance.

EQUITY	Though the GO Bond tax rate is applied uniformly against the property's Assessed Value (AV), due to Proposition 13, properties that have changed ownership will have a higher AV and corresponding burden from a GO Bond tax assessment than those properties with a lower AV.
ADMINISTRATION	The County of Santa Clara charges 0.25 percent to administer the assessment collection via the annual property tax bill. A $100M bond issuance with a $6.6M annual debt service payment would incur $16,500 in annual administrative fees by the County to collect the tax. Considerable cost and staff resources would be incurred associated with the actual bond(s) issuance and ongoing staff time would be necessary to manage the debt service and bond covenant requirement for the bond duration (e.g. 30 years) and the annual GO Bond tax rate calculation which is submitted to the county.
STABILITY	Very stable with low volatility even during a recession.
ECONOMIC BENEFITS	A GO Bond mirrors the current assessment and weight of the baseline 1% property tax assessment. The *ad* valorem levy is the same as the baseline tax structure for both the administrator and the taxpayer, therefore, minimal administrative disruption is anticipated. However, inequities associated with current regulations such as Proposition 13 as referenced above may disproportionately impact certain owners.

The Bay Area GO Bond measures considered in June and November 2018 elections had mixed results, though the majority passed, a few did not. In November 2018, there were eleven non-school GO Bond measures totaling $2.4 billion. Five passed and a total of $1.3 billion in local non-school GO Bonds were issued. In June 2018, there were three local non-school GO Bond measures and two of those measures passed, both cities in the Bay Area. Though the overall passage rates in the last two elections were high, the passage rates for measures for school GO Bonds is higher, 86 percent, than City, 62 percent.

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Summary of Affordable Housing Funding Options

As requested by Council, this attachment provides greater detail on different options for funding affordable housing. It includes an overview discussing affordable housing and then briefly describes various options that can be used to raise revenues for this purpose. Some of the options are already in place in Palo Alto to raise funding for this purpose, while other options may be present in Palo Alto but not specifically directed to affordable housing. Other options are not yet being used in Palo Alto for affordable housing or any other purpose.

Affordable Housing Overview

The Federal Government, through the Department of Housing and Urban Development (HUD), considers housing that requires 30% or less of a household's income as affordable to that household. Once a household pays more than 30% of its income for rent or a mortgage, the household is defined as "cost burdened." Although there is debate about the appropriateness of 30% as the measurement, the proportion of households spending more or less than 30% of their income on rent is one measure of affordability of in a city or region.[1]

The Joint Center for Housing Studies of Harvard University produces maps that show cost burden across the nation.[2] In 2017, the San Jose-Sunnyvale-Santa Clara Metropolitan Statistical Area (MSA), 36% of households were cost burdened, with 17% experiencing severe cost burden. This is similar to the 37%of households cost burdened and 18% severe cost burdened by households in the San Francisco-Oakland-Hayward MSA. Severe cost burdening occurs when a household spends more than 50% of its income on housing costs.

One way to ensure more households can afford housing is by constructing deed-restricted, income-based housing. These units are typically offered for sale and for rent to lower-income households in a region. To determine if a household is lower income, the HUD assesses the median incomes of counties nationwide. Each year, HUD publishes a table for each county identifying the median income, and the incomes of extremely low-, very low-, and low-income households. The table also varies based on household size. As of April 26, 2021, the median income in Santa Clara County for a household of 4 is $151,300.

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[1] Rental Burdens: Rethinking Affordability Measures
https://www.huduser.gov/portal/pdredge/pdr_edge_featd_article_092214.html
[2] Cost Burden Maps by the Joint Center for Housing Studies of Harvard University:
https://www.jchs.harvard.edu/son2019-cost-burdens-map

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Table C-1: Income by Household Size

Santa Clara County Income Table Issued by HUD April 26, 2021[3]								
	Household Size							
Income	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
Extremely Low	$34,800	$39,800	$44,750	$49,700	$53,700	$57,700	$61,650	$65,650
Very Low	58,000	66,300	74,600	82,850	89,500	96,150	102,750	109,400
Low	82,450	94,200	106,000	117,650	127,200	136,600	146,050	155,450
Median	105,900	121,050	136,150	**151,300**	163,400	175,500	187,600	199,700
Moderate	127,100	145,250	163,400	181,550	196,050	210,600	225,100	239,650

Funding Affordable Housing

Since the rents that low-income households can afford to pay are less than the market rent, the private market does not build new housing units for these households. Instead, states, counties, and cities deploy several tools to aid in the construction of deed-restricted, income-based affordable housing. Overall, the tools represent strategies to find funding to either (1) construct the affordable housing or to (2) decrease the cost to construct and operate the housing. Below are some potential funding tools to offset the costs of affordable housing. Those marked with an * are already in place in Palo Alto but may not be specifically dedicated to affordable housing.

- General Taxes*
- Inclusionary Housing Requirements and/or Fees*
- Commercial Linkage Fee*
- Documentary Transfer Tax*
- Jobs-Housing Linkage Policy
- Enhanced Infrastructure Financing District
- Bond Measures
- Project Specific Funding
- California Community Housing Agency
- Use of Public Land and/or Land Lease

General Taxes - Tax revenues can be dedicated to affordable housing through a jurisdiction's budget process, or a jurisdiction can choose to raise a tax and specifically dedicate it to affordable housing. The City of Palo Alto could choose to dedicate existing tax revenues to the construction of affordable housing, could ask voters to dedicate a new tax to affordable housing, or could ask voters to approve a new tax that will be dedicated to affordable housing via the legislative process (budget). Although the City currently collects taxes, none are explicitly allocated towards affordable housing. Either a general tax, requiring a simple majority for passage, or a specific tax, requiring a 2/3 supermajority to pass, could be used for affordable housing.

Below Market Rate Housing Requirements and/or Fees - The City of Palo Alto has two affordable housing programs: 1) Below Market Rate (BMR) and 2) Affordable Housing Fund. The BMR

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program requires housing developers to include below market rate housing units in new housing developments. The City requires that ownership projects include 15% of the units as affordable to moderate income households. Rental projects are required to pay a fee instead of including the units in the development; the fee goes into the Affordable Housing Fund to contribute to 100% affordable housing projects.

The City has explored the feasibility of increasing the inclusionary percentage above 15%. A study completed in 2020 indicated that increasing the rate must be accompanied by adjusting some development standards, otherwise a higher inclusionary rate is not feasible. The state requires that inclusionary rates above 15% must be financially feasible. Staff could return with draft legislation to adjust development standards so that more inclusionary housing is financially feasible. The changes to standards may also allow the City to require on-site BMR units for rental housing projects.

In addition, a series of recent state laws, including the state density bonus, allow developers to become eligible for certain concessions and/or permit streamlining when a certain percentage of units are affordable.

Documentary Transfer Tax - One type of tax the Council may consider for supporting affordable housing is a documentary transfer tax. A documentary transfer tax (transfer tax) is a tax imposed by the County and/or City for the transfer of property. The City could increase this tax and dedicate the revenues to affordable housing.

For example, the City and County of San Francisco passed Proposition I in 2020 by a margin of 57.55% to 42.45%. This tax raised the property transfer tax rate on commercial and residential properties valued between $10 million and $24.99 million from 2.75% to 5.5%, and on properties valued at $25 million or more from 3% to 6%. This was passed as a general tax, though by resolution the revenues were dedicated to housing related funds. The table below presents documentary transfer taxes throughout Santa Clara County to provide context on neighboring jurisdictions.

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Table C-2: Documentary Transfer Tax Rates in Santa Clara County

City	General Law/Chartered	Per $1,000 Property Value (City Rate)	Rev & Tax Code Sec 11911 – 11929 County Rate	Per $1,000 Property Value (Total)
Campbell	General	$0.55	$0.55	$1.10
Cupertino	General	$0.55	$0.55	$1.10
Gilroy	Chartered	$0.55	$0.55	$1.10
Los Altos	General	$0.55	$0.55	$1.10
Los Altos Hills	General	$0.55	$0.55	$1.10
Los Gatos	General	$0.55	$0.55	$1.10
Milpitas	General	$0.55	$0.55	$1.10
Monte Sereno	General	$0.55	$0.55	$1.10
Morgan Hill	General	$0.55	$0.55	$1.10
Mountain View	Chartered	$3.30	$1.10	$4.40
Palo Alto	Chartered	$3.30	$1.10	$4.40
San Jose	Chartered	$2 M AV Exempt	$1.10	$1.10
		1.25% $1M - $3M	$1.10	$13.60
		2.5% $3M - $10M	$1.10	$26.10
		3% > $10 M	$1.10	$31.10
Santa Clara	Chartered	$0.55	$0.55	$1.10
Saratoga	General Law	$0.55	$0.55	$1.10
Sunnyvale	Chartered	$0.55	$0.55	$1.10

Commercial Linkage Fee (CLF) – Commercial linkage fees became effective in Palo Alto in 2017. A CLF is similar to other impact fees levied on new development and helps cover the cost associated with creating new or expanded public facilities to meet the additional demand created by the development. Before levying a CLF, jurisdictions are required by state law to complete a nexus study that shows the linkage between the new development and the increased demand for the facilities. The results of the nexus study establish the maximum legal fee that may be charged.

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Table C-2: CLF Affordable Housing Fee Levels in Santa Clara County (per sq. ft)

Non Residential Fees by City	**Office/R&D**	**Retail**	**Hotel**	**Industrial**
Palo Alto	$36.53	$21.26	$21.26	$21.26
Mountain View*	$28.25	$3.02	$3.02	$28.25
City of Santa Clara	$20.00	$5.00	$5.00	$10.00
Cupertino	$24.60	$12.30	$12.30	$24.60
Sunnyvale**	$17.20	$8.60	$8.60	$17.20
Milpitas	$8.00	$8.00	$8.00	$4.00
Average Fees	**$22.43**	**$9.70**	**$9.70**	**$17.55**

*Mountain View: Office/R&D<10k sq. ft. pays ½ fee. Hotel/Retail <25k sq. ft. pays ½ fee

**Sunnyvale fee for Office/Industrial is ½ fee level up to 20k sq. ft. and full fee for sq. ft. above 20k

Source: siliconvalleyathome.org

Jobs Housing Linkage Policy - A jobs-housing linkage fee is similar to the commercial linkage fee, but it identifies the nexus between commercial development and housing demand. The fee then goes to support the development of housing to meet the demand created by the commercial development. The nexus study can include examining the housing demand generated by the new workforce occupying the commercial facility, but also the demand for other jobs created by the new workers. For example, a new office building may create demand for more low-wage work in the restaurant industry; and those low-wage workers need housing as well as the office workers.

Infrastructure Financing District – The Enhanced Infrastructure Financing District (EIFD) provides broad authority for local agencies to use tax increment to finance a wide variety of projects, including affordable housing, mixed-used development, sustainable development, and transit-oriented development. According to the California League of Cities:

> The EIFD provides broad flexibility in what it can fund. No public vote is required to establish an authority, and though a 55 percent vote is required to issue bonds, other financing alternatives exist. Unlike former redevelopment, this tool imposes no geographic limitations on where it can be used, and no blight findings are required. An EIFD can be used on a single street, in a neighborhood or throughout an entire city. It can also cross jurisdictional boundaries and involve multiple cities and a county. While an individual city can form an EIFD without participation from other local governments, the flexibility of this tool and the enhanced financial capacity created by partnerships will likely generate creative discussions between local agencies on how the tool can be used to fund common priorities.[3]

[3] Source: https://www.cacities.org/Policy-Advocacy/Hot-Issues/New-Tax-Increment-Tools

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This tool does not necessarily collect taxes from a new source but uses the incremental tax increases in a given geography to finance infrastructure investments. Generally, tax increment financing assumes the infrastructure or investment will yield higher tax revenues in the future, allowing the district to afford the investment.

Bond Measures - Bond measures can also be used by different levels of government to fund affordable housing.

For example, the State of California put Proposition 1 on the ballot in 2018. The proposition passed and gave the state permission to borrow $4 billion to fund affordable housing construction as well as rental and home loan subsidies. These were structured as General Obligation (GO) bonds. GO bonds are described in greater detail in **Attachment A**. The money from Proposition 1 can be used to build and renovate rentals ($1.8 billion), to offer home loan assistance to vets ($1 billion), to construct additional housing in dense urban areas and near public transit ($450 million), to offer down payment assistance and other aid to low- and moderate-income homebuyers ($450 million) and to provide loans and grants for agricultural workforce housing development ($300 million). Likewise, Santa Clara County voters passed Measure A in 2016. This bond generated revenues for affordable housing in the county.[4]

Project Specific Funding – The above represent options local governments can use to generate revenues for affordable housing development. In addition to these measures, there are project specific funding sources available for affordable housing developments. For example, the Measure A monies raised by the County are allocated to specific housing projects. Federally, the Low-Income Housing Tax Credit (LIHTC) can provide funding for specific projects. Lastly, state-funded Project Home Key provides funding to create housing for unhoused persons. This funding source is allocated to specific qualifying projects.

The key point is that additional funding sources exist for affordable housing overall. These funds come from different sources and are then allocated to specific projects, not to municipalities or other agencies.

California Community Housing Agency (*Project Specific Funding)* - The California Community Housing Agency (CalCHA)[5] is the State's first public agency focused exclusively on the production, preservation and protection of middle-income housing. The "Essential Housing" model has already created over 2,000 affordable rent-restricted rental units. Founded in 2019, CalCHA is a Joint Powers Authority (JPA) created pursuant to Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California. The JPA purchases existing housing and restricts the

[4] Website regarding Measure A: https://www.sccgov.org/sites/osh/HousingandCommunityDevelopment/AffordableHousingBond/Pages/home.aspx#:~:text=%E2%80%8B%E2%80%8B%E2%80%8BIn%20November,%24950%20million%20affordable%20housing%20bond.&text=The%20bond%20proceeds%20would%20contribute,approximately%204%2C800%20affordable%20housing%20units.

[5] Website: https://www.calcha.org/

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homes to income-qualified households (no more than 120% of area median income). The JPA issues revenue bonds for specific projects. Revenue bonds are project specific bonds that use the revenues of a project to service any debt obligations. Cities that join the JPA have no responsibility or obligation to the bonds. *To be active within the boundaries of a local jurisdiction, the jurisdiction must join the JPA via a resolution.*

Use of Public Land and/or Land Lease – Public agencies may also utilize land owned by the agency for housing. In the Bay Area, land acquisition can be one of the most challenging and expensive parts of building housing—both affordable and market rate. If a government already owns the land, the cost of the housing can decrease significantly. Local governments often issue RFPs to work with private developers to build the housing. The development may be 100% affordable, though subsidies are required from other sources to build the housing. The development may also be a mixed income project that includes both market rate and affordable housing. Often times, with mixed income projects, the low or no-cost land is leveraged for very high amount of below market rate housing (up to 50% or more in some cases). Typically, the government agency enters into a long-term land lease (50 years, 99 years, etc.) with the developer so that the land is still retained as publicly owned. These projects are typically rental housing, and not for sale. Some work has been done to advance community land trust models that do allow ownership of the unit by an individual or family, but retain ownership of the land by a non-profit or government.

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Overview of Prior Work Efforts related to a Business Tax

The City of Palo Alto does not currently have a Business Tax. In 2014, the City approved a Business Registration Certificate (BRC) Program, which has a $54 annual registry fee per business. Due to the impact of COVID-19 on businesses, this fee was waived for FY 2021 and FY 2022. This fee is in addition to any special assessments, such as the Downtown Business Improvement District (BID) or Downtown Parking Assessment District. The BID fees were also waived for FY 2021 and FY 2022 in light of COVID-19.

The discussion of a business tax is not new to Palo Alto. On June 22, 2009, the Palo Alto City Council voted 6-2 to put Measure A, a general tax measure on the November ballot, where it failed to meet the simple majority required for passage. 57.28% of voters voted against the measure and only 42.75% voted in favor. That measure was expected to raise $3 million a year in general fund revenues through a $75 fee on all businesses and an additional cost of $35 to $75 per employee depending on the size of the firm.

In 2016, the Council renewed talks of a business tax, but the effort was dissolved when the Finance Committee opted instead to pursue a hotel tax increase via Measure E. In 2019, by a vote of 6-1, the Council began a new effort to place a business tax on the November 2020 ballot to help support their Fiscal Sustainability priority. Significant work by staff, augmented by consultant resources, was put into the pursuit of developing a potential business tax ballot measure. This included exploration of different options ranging from headcount to square footage to gross receipts. This attachment provides an overview of the prior work efforts including the three paths that were used to organize the work so that could it proceed concurrently.

The three paths were analysis and modeling, stakeholder outreach, and polling. These three paths would likely be used to organize work on an ongoing basis in order to facilitate the necessary conversations in a prompt and timely manner.

- The analysis path consists of creating models to estimate potential revenues, refining those revenue estimates, and incorporating iterative direction on elements of the model such as tiering of rates, exemptions, or other nuances that can be altered. During the 2019 and 2020 work on a potential business tax, the City used Matrix Associates as the consultant to augment the work on analysis.

- The stakeholder outreach path consists of targeted and tailored communication to the community around the potential local ballot measure. This includes both the potential rate-payers that would be impacted by a new local ballot measure and other members of the community. During the 2019 and 2020 work on the development of a potential business tax, the City used TBWB as the consultant to facilitate stakeholder engagement.

- The polling path consists of polling voters on the specific language and elements of a potential ballot measure to inform the wording of the ballot measure and incorporate potential changes to aid the measure's passage. During the 2019 and 2020 work on the development of a potential business tax, the City used FM3 associates as the consultant to engage on polling.

Although the Finance Committee and City Council had given direction to staff to pursue a business tax based on employee headcount, that may no longer be the most viable nor administratively feasible option as a result of changes to the work environment from COVID-19. The remainder of this attachment retransmits information previously sent to the Finance Committee and City Council through CMR 10392 and CMR 10445 to restate the context for a potential business tax and present additional options for re-consideration. Subsequent City Manager Reports that more fully explore a potential employee head-count business tax are listed and available in **Attachment D.**

Limits and Constraints on Business Taxes

The City can consider any tax that is not arbitrary in its application or otherwise prohibited by state law or the constitution. Jurisdictions may only tax conduct with a constitutionally-sufficient nexus to the jurisdiction. For businesses that conduct business in multiple jurisdictions, the city's business license tax can only be applied to the portion of business transacted in the city. Business tax measures follow the same voter thresholds for a general tax or special tax and could be proposed as either.

Some businesses and occupations are exempt from local business taxation under state or federal law; these include non-profit or charitable organizations (e.g., non-profit hospitals), banks and other financial institutions that pay the state in-lieu tax, small residential care facilities, and small home childcare facilities. This list is not exhaustive or exclusive. The City can include other exemptions (e.g., small business, limited duration activity) in addition to the exemptions required under state or federal law in a proposed tax measure.

Analysis of Neighboring Jurisdictions' Business Taxes

Staff reviewed election results for cities in the Bay Area (Santa Clara County, San Mateo County, City and County of San Francisco, Alameda County, Contra Costa County, and Marin County) for business license tax measures in the past five years, that did not specifically target a type of business (such as landlords, parking lots, warehouses, sugary drinks, gaming, cardrooms, gambling, soil recycling and recycling). Over the past five years, general use business tax measures, which require a simple majority vote, have passed at the polls.

Over the past 10 years, there were a handful of examples of business tax measures in the Bay Area that did not pass. An example of a failed business tax measure was in November 2014 for the City of Milpitas (Measure E) that targeted licensed gaming establishments. Measure E would have allowed the City to tax licensed gaming establishments 10.5 percent on gaming revenues.

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According to Ballotpedia.org, the following business tax measures in the Bay Area, that did not target a specific business type and failed on the ballot were in November 2009 for the City of Redwood City (Measure Y, business tax increase) and City of Palo Alto (Measure A, to establish a business tax). City of East Palo Also voters passed Measure O (a general tax) in November 2016 by simple majority which, in addition to the City's business license tax assessed on the business community at-large, added a landlord business license tax to the City's overall business tax structure.

As part of the effort in 2019, the City engaged Matrix Consulting Group (Matrix) to conduct research that will assist in development of a potential business license tax. The scope of the engagement included

- comparative research of selected Bay Area communities to understand each agency's business license tax practices regarding the development, implementation, and administration of each program; and
- to perform data analysis and modeling, based on available data resources, of the potential revenue range the City may generate if a business license tax measure were to be approved by the voters.

Comparative agencies were selected based on a few general criteria: proximity to Palo Alto, business community and population size, business industry environment, and Bay Area agencies that have brought business license tax measures to the ballot in the last few years. 2017 data from the U.S. Census was used to compare Palo Alto's industry environment to selected comparable agencies. The Business License Tax Program Comparative Assessment and Revenue Projections report completed by Matrix, which can be found as Attachment C to CMR 10445, indicated that according to U.S. Census Data for 2017, Palo Alto's business environment was comparable to the selected agencies, where professional and healthcare services are the top industry types. The U.S. Census data, however, includes business conducted in Stanford, which is primarily business in the education and healthcare segments and depending on location, these businesses would not be subject to a Palo Alto Business License Tax.

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Table B-1: Employment by Industry as of 2017

INDUSTRY	***Cupertino***	***East Palo Alto***	***Mountain View***	***Redwood City***	***San Francisco***	***San Jose***	***San Mateo***	***Santa Clara***	***Sunnyvale***	***Palo Alto***
PROFESSIONAL	29%	6%	23%	14%	22%	13%	15%	21%	27%	**25%**
INFORMATION	7%	3%	13%	5%	6%	4%	5%		8%	**8%**
MANUFACTURING	22%	7%	13%	8%	4%	16%	9%	19%	20%	**13%**
EDUCATION	7%	8%	9%	9%	7%	8%	8%	8%		**14%**
HEALTHCARE	9%	12%	9%	11%	11%	12%	11%	9%	15%	**11%**
RETAIL	7%	12%	7%	10%	9%	9%	9%	8%		**5%**
HOSPITALITY	3%	14%	6%	7%	9%	8%	9%	6%	6%	**5%**
ADMINISTRATIVE		11%	3%	6%	4%	5%	6%			**2%**
CONSTRUCTION	2%	8%	3%	7%	3%	6%	5%	3%		**1%**

Professional, scientific and technical services is the largest industry segment in the City of Palo Alto. To further validate the U.S. Census data and to review average number of firms, employees and employee wages, the City obtained data from the California Employment Development Department (EDD) which excludes businesses located at Stanford. Please see the "Employment and Wages by Northern American Industry Classification System (NAICS) Code from EDD Data" table on p. 39 in the Consultant Study – page 70 of CMR 10445 - for detail of the City's 2018 number of firms, employment, total annual wages, and average employee wage, organized by Industry NAICS code. Please note that data for some industry types are suppressed from the report due to EDD's confidentiality and disclosure restrictions. Although grand totals for number of firms, employment, and annual wage is included in the report, information for an industry is redacted if the industry category 1) has less than five reported business in that industry and 2) one business comprises 80 percent or more of the total for the industry.

According to the EDD data, in 2018 the City of Palo Alto had:

Approximately 942 professional, scientific, and technical firms (NAICS code 54), or 22 percent of total reported businesses, within the City that are dedicated to this industry type. Healthcare and social assistance and other services (excluding public administration), are the second and third largest industries totaling 854 firms (20 percent) and 495 firms (12 percent), respectively.

The average employee wage data (which includes regular salary, bonuses, and sometimes stock option income) is also telling of the type of employment market within the City. The highest paid industries in the City are finance and insurance, averaging approximately $307 thousand per employee; information, averaging $296 thousand per employee; and management of companies and enterprises, averaging $242 thousand per employee.

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In 2018, there was an average of 103,921 employees within City limits (excluding Stanford). Of those employees, 97,350 were non-government employees. This data is presented in the Consultant Report and the verified data from InfoGroup was used to calculate the employee head count revenue estimate.

Agency demographic information that was examined in the Consultant Study included

- population
- number of businesses;
- total revenue generated and percent total of General Fund revenues;
- business tax revenue generated compared to total agency full-time equivalent (FTE) as a benchmark unit of measure;
- whether the tax is general or specific;
- business tax structure;
- exemptions in addition to those specified in State or Federal law;
- sunset of the tax;
- annual escalator; and
- whether the tax is administered in-house or by an outside firm.

Of the agencies selected for comparison, all agencies approved ongoing taxes without sunset provisions and chose to administer the tax in-house. Each agency had varying types of tax exemptions and methods of an annual escalator for the tax. The tables below summarize the demographic and business license tax information for each selected agency and how each compare to Palo Alto as well as business tax exemptions by agency. Five of the nine selected agencies use employee head count as the tax method; all but East Palo Alto have a general tax.

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Table B-2. City Demographic and Business Tax – General and Financial Information (As of August 2019)

CITY	POPULATION	# OF BUSINESSES	THREE LARGEST INDUSTRIES	TAX METHOD	GENERAL OR SPECIAL TAX	REVENUE / % GENERAL FUND	REVENUE PER FTE
CUPERTINO	60,777	3,800	Professional Manufacturing Healthcare	Square Foot	General	$0.8M, 1%	$4,344
EAST PALO ALTO	29,765	1,527	Hospitality Healthcare Retail	Gross Receipts	Specific	$1.2M, 4%	$10,239
MOUNTAIN VIEW	81,438	3,700	Professional Information Manufacturing	Employee Count	General	$6.0M, 4%	$9,438
REDWOOD CITY	86,685	6,275	Professional Healthcare Retail	Employee Count	General	$2.6M, 2%	$4,757
SAN FRANCISCO	884,363	242,000	Professional Healthcare Hospitality	Gross Receipts; Payroll	General	$820.0M, 9%	$26,469
SAN JOSE	1,035,000	58,000	Manufacturing Professional Healthcare	Employee Count	General	$72.2M, 6%	$11,259
SAN MATEO	104,748	7,486	Professional Healthcare Retail	Gross Receipts	General	$5.9M, 5%	$8,659
SANTA CLARA	127,134	13,000	Professional Manufacturing Healthcare	Employee Count	General	$0.9M, 0.5%	$823
SUNNYVALE	152,389	7,875	Professional Manufacturing Healthcare	Employee Count	General	$1.8M, 1%	$2,027
PALO ALTO	**66,649**	**5,496**	**Professional Healthcare Manufacturing**	**N/A**	**N/A**	**N/A**	**N/A**

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Table B-3: Business Tax Exemptions by Agency

	STATE EXEMPTIONS		LOCAL EXEMPTIONS			
CITY	Non-Profit	Charitable Organizations	Public Utility	Small Business	Disabled Veteran	Low Income Rental Units
CUPERTINO	✓	✓				
EAST PALO ALTO	✓	✓				
MOUNTAIN VIEW	✓	✓	✓			
REDWOOD CITY	✓	✓	✓		✓	
SAN FRANCISCO	✓	✓		✓		
SAN JOSE	✓	✓		✓		✓
SAN MATEO	✓	✓			✓	
SANTA CLARA	✓	✓				
SUNNYVALE*	✓	✓	✓		✓	

*** BANKS AND OTHER FINANCIAL INSTITUTIONS THAT PAY THE STATE IN-LIEU TAX ARE EXEMPT FROM A LOCAL BUSINESS TAX. THE CITY OF SUNNYVALE EXEMPTS ALL BANKS AND FINANCIAL INSTITUTIONS FROM THE LOCAL BUSINESS LICENSE TAX.**

On June 18, 2019, staff received direction from the Finance Committee to model three types of business tax models: employee head count, square footage, and payroll. In addition to these structures, staff was directed to examine potential exemptions, in addition to those legally exempted, to provide the Committee with information to make informed policy decisions for the tax. The below discussion summarizes the results of the business license tax modeling from 2019 as presented in the Consultant Study, which is Attachment C of CMR 10445.

*Table B-4: Estimated Business Tax Annual Revenue**

HEAD COUNT	$3.6M using City of Mountain View's rates
SQUARE FOOTAGE	$1.0M to $3.2M using City of Cupertino's rates
PAYROLL	$15.5M to $16.5M assuming 0.1% of total payroll expense

***REVENUE ESTIMATES INCLUDE EXEMPTED BUSINESS CATEGORIES PER STATE AND FEDERAL LAW, SUCH AS NON-PROFIT AND CHARITABLE ORGANIZATIONS.**

Business Tax: Employee Head Count

Fundamentally, the employee head count business tax model applies a tax rate based on the number of people a business employs within the City's boundaries. The tax rates are commonly separated into ranges and the tax is applied based on how many people are employed by the business. In our survey of comparative agencies, employee head count is the most common business tax structure and, perhaps the simplest form business tax model.

For purposes of a headcount business tax structure, establishing a definition for an "employee" will be the foundation of this tax and can be defined as any person who works for, under the direction of, on behalf of, or as an agent of a business owner. Amidst the growing trend of non-traditional employment structures (i.e. outside consultants, employees working from sites outside of City boundaries) in information and professional services industries, establishing the definition and criteria of an employee and setting a tax around such definition will be critical.

Staff recognizes that there a wide range of datasets which identify number of employees citywide, with varying conclusions of the total number of employees in the City of Palo Alto. Several reasons may be the cause of this – inclusion of businesses located in Stanford proper, various definitions of an employee, confidentiality parameters, or how the data is collected (self-reported, mandated, audited, etc.) – just to identify a few. Site-based employment headcount and wage data, in total, is available from the EDD. Staff has previously presented employee head count totals from the American Community Survey, which totaled 97,000. InfoGroup is another data set that was utilized in the City Auditor's Office most recent audit of the Business Registry Certificate Program. The revenue estimates presented in the Consultant Report are modeled using the verified database from InfoGroup. The verified data from InfoGroup provided the most detailed information by firm at the time of the analysis.

EQUITY	*Palo Alto's top three industry types for average employee head count are healthcare/social assistance, professional, and information.* This tax model would directly relate revenue to the daily phenomena of the influx of daytime population within the City's boundaries and tax this activity as such. Equity concerns within the same type of industry are to be determined, however, businesses that are labor driven and have lower average wages will be bear a higher tax based on employee head count and such as tax will not correlate to the business' ability to pay. Examples of these industries are manufacturing, retail, social assistance, and food service/hospitality.
ADMINISTRATION	Establishing criteria that sets the definition of an employee should be included so that businesses are able to accurately report data and remit tax. Self-reported employee head count by the business owner would be the simplest method of administering this tax, however there is a higher risk that data is reported incorrectly. An alternative is to use data from the EDD and assess the tax based on this data. Data on firm size is currently being generated by the EDD. The recently passed business tax measure in Mountain View, Measure P, calculates the tax based on the employee count form the last four quarters submitted to the EDD. Structure for this tax model should define whether headcount related to from alternative employment models should be included or not be included in the assessment.

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STABILITY	Tax revenue driver is directly related to how many businesses are in the City and the number of employees at each business. Depending on the policy is developed and how the tax definitions are written, the basis will be impacted as companies transition to alternative employment models (i.e. outside consultants, employees working from offsite locations outside of City boundaries), which is becoming a trend in consulting and high-tech companies.
ECONOMIC BENEFITS	Administration of the tax is simple if based on number of employees at a site address, which is already reported by businesses to the EDD on a quarterly basis; results in minimal operational disruption to the tax payor. Implications of economic development goals would be dependent on the specific structure, potential exemptions, and business classifications

Of the nine selected comparison agencies, five of the cities used employee head count as the tax method. Although total employee count for each selected agency could not be readily obtained as of the drafting of the report, a summary table of those agencies is below, similar to the table presented earlier in this report, that includes the number of businesses, tax method, exemptions, total generated revenue, and revenue per FTE:

Table B-5: Employee Headcount Agencies

CITY	# OF BUSINESSES	TAX METHOD	EXEMPTIONS	REVENUE	REVENUE PER FTE
MOUNTAIN VIEW	3,700	Base tax plus tiered incremental rate (scaled increase)	Public Utility	$6.0M	$9,438
REDWOOD CITY	6,275	Base tax plus flat tax based on employee or business type	Public Utility Veteran	$2.6M	$4,757
SAN JOSE	58,000	Tiered incremental rate (scaled decrease)	Small Business Low-Income Rental Units	$72.2M	$11,259
SANTA CLARA	13,000	Tiered flat rate (scaled increase) or flat; has cap		$0.9M	$823
SUNNYVALE	7,875	Tiered incremental rate (scaled increase)	Public Utility Veteran	$1.8M	$2,027

Generated tax revenue compared to City FTE was used as a benchmark to compare each agency's business license tax. The cities of Redwood City and Santa Clara both use employee count as the tax method. Redwood City generates $2.6 million annually and has approximately half the number of business firms compared to City of Santa Clara. However, Redwood City generates three times the amount of business license tax revenue compared to Santa Clara. The driver of this difference is that Redwood City's employee count model incrementally increases based on number of employees, where Santa Clara's model is a flat tax.

The City of Sunnyvale also uses the employee head count model and, in addition to businesses that often times are exempt or receive preference from a grant perspective (such as non-profits,

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residential care facilities, or Veteran-operated businesses), Sunnyvale exempts banks and financial institutions and insurance brokers-agents. Like Redwood City, but unlike Santa Clara, Sunnyvale uses an incremental employee count model as opposed Santa Clara's flat tax model. This results in approximately $1.8 million in annual revenue and $2,027 in tax revenue per FTE.

City of San Jose is the largest agency, for both population and number of businesses, that uses the employee head count model. It is also the only agency that was reviewed that encourages large business by using a tiered model where the tax rate is incrementally scaled down as the business has more employees and has a total maximum cap that can be collected per year.

Business Tax: Square Footage
The square footage business tax model commonly calculates the tax based on a tiered square footage range. There are several options of how a square footage tax can be structured by either applying a single square footage rate, depending on which tier the business falls under; a flat tax based on tier; or a combination of a flat tax and square footage rate. The rates can be structured to either benefit or penalize certain commercial space sized businesses.

Real estate market analytic tools are available for purchase and provide dependable, real-time, census information that can be used as a tool for administration, regulation, and revenue forecasting purposes. The Consultant Study used verified InfoGroup data to perform tax revenue modeling and also reviewed data from CoStar, a real estate market analytical tool which categorizes commercial property into several categories (distribution/manufacturing, healthcare, hospitality, industrial, office by class, retail, specialty, and sports/entertainment) and into various subcategories. Data from CoStar (available LINK) also discloses whether the commercial space is owner occupied, leased, or sub-leased. These lease arrangements should be considered when structuring, administering, and regulating this tax model. Matrix found that the data from InfoGroup appeared to have the largest population of reported businesses within its "verified" roster.

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EQUITY	If industries within the City require an average square footage that is similar to the business' competitors, the tax burden would fall equally among businesses in the same industry. This tax model would place heavier tax burden on industries that require larger square footage to operate, such as manufacturing.
ADMINISTRATION	The source of compliance data would be an actively maintained and updated third-party real estate database. Whether the commercial space is owner occupied, leased, or sub-leased, how regulation is administered, and allocation of the tax is administered by the property owner or the City should be addressed and clarified in the tax language. Examples of complex areas in this tax structure are common areas, shopping centers, franchises and how a business may define their company's site(s).
STABILITY	Tax is assessed on commercial square footage and, although some exemptions can be made to encourage certain industries to expand in the City, overall revenue growth using this model will be limited based on policy decisions related to commercial space in the City.
ECONOMIC BENEFITS	This tax model would appear to inhibit square footage growth, however depending on how the tax is structured, this model has the potential to encourage growth for targeted industries and/or business sizes and/or property types.

Of the nine selected agencies in the Consultant Study, the City of Cupertino was the only agency that used the square footage tax method for a business tax. It should be noted as discussed earlier in this report that the City of East Palo Alto recently approved a parcel tax based on a commercial square foot metric.

Table B-6: Square Footage Agency

CITY	# OF BUSINESSES	TAX METHOD	EXEMPTIONS	REVENUE	REVENUE PER FTE
CUPERTINO	3,800	Flat base rate plus tiered incremental rate (scaled decrease)	Non-Profits	$0.8M	$4,344

Cupertino considered a November 2018 ballot measure to restructure the City's business license tax, which was enacted in 1992, however it was decided to defer the proposed tax restricting plan to the November 2020 election. The proposed structure would shift Cupertino's business license tax from square footage to employee head count, which is consistent with most agencies selected in the Consultant Study. According to the City of Cupertino's website, restructuring the business license tax would generate approximately $10 million annually and would fund the City's transportation infrastructure and traffic congestion programs.

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Business Tax: Payroll Expense
Using payroll data as the basis for a business tax is similar to the methodology of an employee headcount structure. Relevant data can be accessed through the EDD and the sensitivity of the tax resets on the composition of employees in the data but instead of the focus being the volume of employees, the focus is on how much employees earn. Based on data from the EDD, approximately half of the City's job market is in high wage sectors including information and professional services. Based on the City's business environment and economy, a tax structure based on payroll earnings would result in a progressive tax that relates the amount of tax paid by the business to the ability to pay the tax.

In considering the payroll tax model, the definition of wages should be detailed enough to determine the type of pay that should be included in the calculation of the tax. The policy choice of including earnings aside from regular wages such as overtime, commission, allowances, bonuses, stock options, and/or cash fringe benefits, should be considered when structuring the payroll tax model.

EQUITY	Wage data will include bonuses and sometimes stock options, which can drastically vary across industries and within sub-categories of an industry. Based on the industry data from EDD, the higher wages are in professional services industries which indicates the average employee wage is higher than manufacturing, retail, social assistance, and food service/hospitality industries.
ADMINISTRATION	Similar to a business tax based on employee headcount, the simplest form of administration would be self-reported by the business owner, however there is a risk that data is reported incorrectly. Data from the EDD can validate and support regulation of this tax structure. Similar to the employee headcount tax model, the payroll tax model will be impacted as companies transition to alternative employment models. Structure for this tax model should define how wages for such employees are included in the tax.
STABILITY	Tax revenue driver is directly related to how many businesses are in the City and the average employee wage. According to data from the EDD, high wage sectors in the City are information, financial activities, and professional services which is comprises half of the City's employment base.
ECONOMIC BENEFITS	Administration of the tax is simple if based on wages of employees at a site address, which is already reported by businesses to the EDD on a quarterly basis; results in minimal operational disruption to the tax payor. Depending on structure, this model has the potential to encourage growth for targeted industries and/or business sizes and/or employee types.

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The City and County of San Francisco was the only city of the nine selected in the Consultant Study that uses the payroll expense tax method to assess the City's business license tax. Prior to the November 2012 election, San Francisco used the payroll expense tax as the City's tax method and was the only city in California to use the payroll expense tax method. The gross receipts method was approved by voters in November 2012, with implementation beginning 2014 over a five-year period. The Consultant Study details the structure for both the gross receipts method and payroll expense method. The table below illustrates San Francisco's payroll expense tax method.

Table B-7: Payroll Expense Agency

CITY	# OF BUSINESSES	TAX METHOD	EXEMPTIONS	REVENUE	REVENUE PER FTE
SAN FRANCISCO	884,363	Payroll phase-out over 5 years: 1.35% to 0% by end of 2019	Small Businesses	$820.0M	$26,469

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Summary of Prior Work on Potential Revenue Generating Ballot Measures

As discussed in the body of City Manager's Report (CMR) 12299, the City of Palo Alto has been discussing its options for potential revenue-generating ballot measures through 2019 and 2020. This work was suspended at City Council direction in March 2020 in order to marshal available resources to manage through the COVID-19 pandemic. A brief timeline of the CMRs and discussions with the Finance Committee and the City Council since April of 2019, when staff was formally directed to begin working on this project by the City Council, is included below for additional context. The date, the forum of the meeting (Finance Committee or City Council), the summary title, and the CMR number are included for ease of reference.

Timeline:
4/22/2019 City Council, "2019 Fiscal Sustainability Workplan", CMR 10267

4/22/2019 City Council, "Approve Workplan for a Potential Revenue Generated Ballot Measure", CMR 10261

6/18/2019 Finance Committee, "Review, Comment, and Accept Preliminary Revenue Estimates for Consideration of a Ballot Measure", CMR 10392

8/20/2019 Finance Committee, "Evaluation and Discussion of Potential Revenue Generating Ballot Measures", CMR 10445

9/16/2019 City Council, "Evaluation and Discussion of Potential Revenue Generating Ballot Measures and Budget Amendment", CMR 10615

10/1/2019 Finance Committee, "Revised Workplan for Consideration of a Ballot Measure", CMR 10712

10/15/2019 Finance Committee, "Stakeholder Outreach, Initial Polling, and Discussion of a Potential Ballot Measure", CMR 10743

11/4/2019 City Council, "Potential Ballot Measure Polling/Outreach, Contract, Solicitation Exemption and Budget Amendment", CMR 10792

12/2/2019 City Council, "Structure and Scenarios of Initial Round of Polling for a Potential Local Tax Measure", CMR 10891

12/17/2019 Finance Committee, "Consideration, Evaluation, and Discussion of a Revenue Generating Local Tax Ballot Measure, Review of Refined Modeling, Analysis, Tax Structure and Recommendation to the City Council", CMR 10655

1/27/2020 City Council, "Update, Consideration, and Potential Direction on Possible Local Tax Measure for 2020 Election", CMR 11019

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3/23/20 City Council, "Consideration of Analysis, Public Outreach, and Refined Polling and Further Direction on a Potential Local Business Tax Ballot Measure for 2020 Election", CMR 11161

3/23/20 City Council, "Consideration of Analysis, Public Outreach, and Refined Polling and Further Direction on a Potential Local Business Tax Ballot Measure for 2020 Election", *At-Places Memorandum*

Schedule of Meetings

This is a courtesy notice only. Meeting dates, times, and locations are subject to change. Almost all Palo Alto Council and some Standing Committee meetings are cablecast live on Channel 26. If there happens to be concurrent meetings, one meeting will be broadcast on Channel 29.

Until further notice, all meetings will be held by virtual teleconference via Zoom and streamed on YouTube.

MONDAY, AUGUST 9
Sp. City Council Meeting, 5 p.m.

TUESDAY, AUGUST 10
Policy & Services Committee Meeting, 7 p.m.

THURSDAY, AUGUST 12
Human Relations Commission Meeting, 6 p.m.

MONDAY, AUGUST 16
Sp. City Council Meeting, 5 p.m.

TUESDAY, AUGUST 17
Sp. Finance Committee Meeting, 6 p.m.

THURSDAY, AUGUST 19
Architectural Review Board Meeting, 8:30 a.m
City/School Liaison Committee, 8:30 a.m.
Public Art Commission Meeting, 7 p.m.

MONDAY, AUGUST 23
Sp. City Council Meeting, 5 p.m.

TUESDAY, AUGUST 24
Parks & Recreation Commission Meeting, 7 p.m.

WEDNESDAY, AUGUST 25
Planning & Transportation Commission Meeting, 6 p.m.

MONDAY, AUGUST 30
Sp. City Council Meeting, 5 p.m.

WEDNESDAY, SEPTEMBER 1
Sp. Utilities Advisory Commission, 5 p.m.

THURSDAY, SEPTEMBER 2
Architectural Review Board Meeting, 8:30 a.m.

TUESDAY, SEPTEMBER 7
Sp. Finance Committee Meeting, 6 p.m.

Persons with disabilities who require auxiliary aids or services in using City facilities or programs, or who would like information on the City's compliance with the Americans with Disabilities Act (ADA) of 1990, may contact: ADA Coordinator, City of Palo Alto, 650-329-2550 (voice) or 329-1199 (TDD), ada@cityofpaloalto.org. Listening assistive devices are available in the Council Chambers. Sign language interpreters will be provided upon request with 72 hours advance notice. Please advise the City Clerk's Office (650-329-2571) of meetings or changes by 3:00 p.m. on Wednesdays for inclusion in the following week's schedule.