



FINANCE COMMITTEE
Tuesday, October 19, 2021
Regular Meeting
Virtual Meeting
6:00 PM

*****BY VIRTUAL TELECONFERENCE ONLY*****

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Pursuant to the provisions of California Governor's Executive Order N-29-20, issued on March 17, 2020, to prevent the spread of Covid-19, this meeting will be held by virtual teleconference only, with no physical location. The meeting will be broadcast on Midpen Media Center at <https://midpenmedia.org>. Members of the public who wish to participate by computer or phone can find the instructions at the end of this agenda. Members of the public may speak to agenda items; up to three minutes per speaker, to be determined by the presiding officer. All requests to speak will be taken until 5 minutes after the staff's presentation. Public comment may be addressed to the full Finance Committee via email at City.Council@cityofpaloalto.org and available for inspection on the City's website. Please clearly indicate which agenda item you are referencing in your email subject line.

CALL TO ORDER

ORAL COMMUNICATIONS

Members of the public may speak to any item NOT on the agenda.

ACTION ITEMS

1. Discuss Updates and Recommend Further Refinement of Potential Revenue Generating Local Ballot Measures, and Review Draft Initial Polling Outline

[Presentation](#)

FUTURE MEETINGS AND AGENDAS

ADJOURNMENT

PUBLIC COMMENT INSTRUCTIONS

Members of the Public may provide public comments to virtual meetings via email, teleconference, or by phone.

1. **Written public comments** may be submitted by email to city.council@cityofpalto.org.
2. **Spoken public comments using a computer or smart phone** will be accepted through the teleconference meeting. To address the Council, click on the link below to access a Zoom-based meeting. Please read the following instructions carefully.
 - You may download the Zoom client or connect to the meeting in- browser. If using your browser, make sure you are using a current, up-to-date browser: Chrome 30+, Firefox 27+, Microsoft Edge 12+, Safari 7+. Certain functionality may be disabled in older browsers including Internet Explorer. Or download the Zoom application onto your phone from the Apple App Store or Google Play Store and enter the Meeting ID below
 - You may be asked to enter an email address and name. We request that you identify yourself by name as this will be visible online and will be used to notify you that it is your turn to speak.
 - When you wish to speak on an Agenda Item, click on "raise hand." The Clerk will activate and unmute speakers in turn. Speakers will be notified shortly before they are called to speak.
 - When called, please limit your remarks to the time limit allotted.
 - A timer will be shown on the computer to help keep track of your comments.
3. **Spoken public comments using a phone** use the telephone number listed below. When you wish to speak on an agenda item hit *9 on your phone so we know that you wish to speak. You will be asked to provide your first and last name before addressing the Council. You will be advised how long you have to speak. When called please limit your remarks to the agenda item and time limit allotted.

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City of Palo Alto

Finance Committee Staff Report

(ID # 13648)

Report Type: Action Items

Meeting Date: 10/19/2021

Title: Discuss Updates and Recommend Further Refinement of Potential Revenue Generating Local Ballot Measures, and Review Draft Initial Polling Outline

From: City Manager

Lead Department: Administrative Services

RECOMMENDATION

Staff recommends that the Finance Committee:

- A. Review the refined calculations of a potential tax on non-residential square footage and recommend that the City Council direct staff for further refinement of a potential business tax, including the following tax structure components:
 1. Tax method of the square footage tax (i.e. parcel or business tax), considering simplicity in administration of the tax
 2. Exemptions by City Council policy
 3. Taxation level as a dollar value or percent of General Fund
 4. Rate structure (i.e. flat or tiered)
 5. Other tax attributes, such as general or specific tax, annual escalator, sunset clause, or minimum threshold of square footage
- B. Review the refined calculations of a potential utility on-bill tax for gas usage and consider potential exemptions by City Council policy, the taxation level, rate structure, and other tax attributes
- C. Review and refine draft outline of initial polling and that the City Council direct staff to proceed with initial polling.

EXECUTIVE SUMMARY

This report continues the Finance Committee's discussion and work to explore the development of a potential revenue generating local measure for the November 2022 ballot and seeks to identify and refine structure and components of a potential business tax ballot measure and/or utility on-bill tax, through iterative conversations with the Finance Committee and City Council. The City's current financial condition, elevated by economic impacts of the pandemic and the City's utility transfer litigation, is the impetus for restarting this conversation. The City of Palo Alto has continuously worked towards fiscal sustainability over the past decade through several actions, and most recently outlined in the Community and Economic Recovery

workplan and City Council Priority in 2021, includes exploration of a revenue generating local tax measure as a component. The economic impacts and uncertainty of the novel coronavirus pandemic resulted in a \$40 million gap between revenues and expenses in the General Fund that were bridged through significant reductions and cost containment measures. At the onset of the pandemic, the City Council decided to pause efforts in exploration of a ballot measure. In addition, in FY 2021 a local court held that a portion of the City's annual transfer from the gas and electric utilities could no longer lawfully continue, absent voter approval. The results of the lawsuit will have important implications for the City, as well as other municipal utilities and cities in California. On September 20, 2021, the City Council voted to appeal the trial court's decision in this class action lawsuit.

This report contains key information that will facilitate this discussion by providing, per the Finance Committee's direction:

- Square footage tax (**Attachment A**):
 - Updated tax models, including revised revenue targets
 - Legal framework around a square footage-based parcel tax and business tax
- Utility on-bill tax refined calculations and discussion of options (**Attachment B**)
- Draft initial polling outline for the Committee's discussion and feedback (**Attachment C**)
- Summary of Prior Work on Potential Revenue Generating Ballot Measures (**Attachment D**)

BACKGROUND

The City's efforts in advancing fiscal sustainability have grown over the past decade. In 2019, several actions and plans were specifically outlined in the Fiscal Sustainability Workplan. The goal of the workplan was to continue to make proactive progress towards fiscal sustainability to maintain the quality of life that the City of Palo Alto supports through its services. Elements of the workplan included proactive funding contributions for the City's long-term pension and other post-employment benefits (OPEB) and strategies to structurally balance and contain cost in the City's General Fund on an ongoing basis.

The economic impacts of the COVID-19 pandemic, and efforts to contain and mitigate the spread of the virus resulted in a \$40 million General Fund gap between revenues and expenses in the FY 2021 Adopted Budget. This gap was balanced through significant service reductions throughout the organization, concessions from the City's labor groups, as well as substantive reductions in the City's capital investments, impacting catch-up and keep-up costs and funding of new projects. In FY 2022, the Adopted Budget was adjusted for both the current impacts of the pending litigation, the recovery period of the pandemic, and reliance on a one-time funding bridge to delay further service reductions beyond those approved in the FY 2021 Adopted Budget. Significant service reductions taken in FY 2021 persist this year and on an ongoing basis unless revenue levels can be brought in alignment with expense levels. This report represents

the next step of discussions with the Finance Committee and City Council regarding a potential revenue generating ballot measure to balance the structural financial needs of the City.

In March 2020, the City Council, considering the uncertain economic impacts of the pandemic, paused efforts to explore a revenue generating ballot measure. Resumption of this review was later outlined in the Community and Economic Recovery Workplan and Council Priority in 2021. On June 15, 2021, the Finance Committee reviewed the Workplan for the November 2022 Local Ballot Measure(s) and Affordable Housing Funding Referral ([CMR 12299](#)), where the Finance Committee recommended that the City Council:

- Approve the Ballot Measure Workplan, with a focus on development of a business tax and a utility use-based tax,
- Refinement of estimates, evaluation of a stakeholder outreach plan and polling, and
- Additional information regarding affordable housing.

These Finance Committee recommendations were considered by the City Council in their August 16, 2021 meeting ([CMR 12381](#)). Consistent with past practice, the City Council directed the Finance Committee be the main deliberative body for the development of the potential revenue generating ballot measure and, through an iterative process outlined in the Ballot Measure Workplan, that updates will be taken to the City Council for review through June 2022. The Summary of Prior Work on Potential Revenue Generating Ballot Measures is included in this attachment. At this meeting, the City Council approved the Ballot Measure Workplan for the November 2022 General Election and directed the Finance Committee:

- Pursue a business tax and the preference of a square footage-based tax;
- Continue exploration of a utility use-based tax and options to incorporate revenue on climate adaptability
- Refine estimates and continue evaluation of potential tax measures, and
- The Finance Committee to discuss and develop initial polling to inform future exploration.

In the September 21, 2021 Finance Committee meeting, the Committee directed staff to continue this exploration by returning to the Committee with refined modeling and additional information. The Finance Committee's motion is as follows:

MOTION: *Council Member Filseth moved, seconded by Chair Cormack to recommend the City Council direct staff to:*

- A. *Continue to evaluate a business tax based on square footage with a potential protection/deference to small retail and services with a view towards simplicity in administration (\$10-\$40 million dollars per year), with no sunset, an annual escalator, and consider a minimum threshold of square footage*
- B. *Model a Utility Users Tax increase in gas to restore the amount at risk from the Green litigation*

- C. *Polling should include:*
 - a. *Support for a business tax and characteristics of it*
 - b. *Willingness to support an equity gas transfer*
 - c. *Opinion and ranking of funding priorities such as services, infrastructure, and climate action*
- D. *Delegate review of the polls to the Finance Committee, pending ability to stay on the timeline*
- E. *Direct staff to communicate the Finance Committee's preferences of the sunset and the annual escalator to the Council.*

MOTION PASSED: 3-0

This report contains key information that will facilitate this discussion for items A, B, and C of the Finance Committee's motion, by providing:

- Square footage tax (**Attachment A**):
 - Updated tax models, including revised revenue targets
 - Legal parameters around a square footage-based parcel tax and business tax
- Utility on-bill tax refined calculations and discussion of options (**Attachment B**)
- Draft initial polling outline for the Committee's discussion and feedback (**Attachment C**)
- Summary of Prior Work on Potential Revenue Generating Ballot Measures (**Attachment D**)

DISCUSSION & ANALYSIS

The Discussion & Analysis section of this report outlines key components for the Finance Committee's discussion regarding a square footage tax, using either a parcel tax or business license tax methodology; additional information for a utility on-bill tax; and a draft outline of the initial polling. In addition, each of these topics is further discussed in the attachments of this report, which are referenced within each title below.

The City Council directed staff to further explore a potential revenue generating local tax measure as a means of generating additional revenue from businesses operating within the City, with the preference of using non-residential (i.e. commercial) square footage occupancy as the unit of measure for such a tax. In addition, the City Council directed staff to explore a potential utility on-bill tax, and review options to support climate adaptability goals. This is the second planned discussion with the Finance Committee regarding potential revenue generating local tax measures for the November 2022 election. This report continues this discussion and outlines staff's completed research and analysis since the September 21, 2021 Finance Committee ([CMR 13514](#)) and summarizes implications of each tax base. This direction was further refined by the Finance Committee on September 21, 2011, where the Committee directed staff to model a utility on-bill tax to restore the amount at risk from the Utility Transfer Litigation.

Square Footage Tax (Attachment A)

A discussion of procedural requirements, approval thresholds and exemptions for a Parcel Tax (non-residential) and Business Tax (measured by square footage occupied) is at **Attachment A**.

Modeling and Analysis

The key component of the square footage tax is determination of the tax method: parcel tax or business license tax. Calculations using data from the City's property tax consultant, Coren and Cone (an HdL Company) were presented to the Finance Committee in the September 21, 2021 meeting. As in the discussion on September 21st, staff considers the 20,000 square foot threshold to be a baseline for small retail and services that may also include other neighborhood amenities (i.e. grocery stores, restaurants). Since the data from Coren and Cone are from the County of Santa Clara and is used for property tax analysis, inherent limitation of data, including category and classes, and lack of information on building square footage, preclude precise revenue outcomes; it is important to acknowledge that these models are calculations using parcel data. In addition, revenue targets modeled below will shrink as the City Council selects exemptions and further refinements.

Table A2: Annual Flat Rate per Square Foot by Small, Medium, and Large Footage below models a flat square footage tax for businesses that occupy more than 20,000 square feet; Table A2 can be found in its complete form in **Attachment A**.

Table A2: Annual Flat Rate per Square Foot by Small, Medium, and Large Footage			
		Medium 30,000 Square Feet	Large 100,000 Square Feet
Types of Businesses		Office buildings, retail, specialty shopping centers, service stations	International Hotel Brands, manufacturing
Total Square Footage in City, excluding less than 20,000 sf (Table A3)	\$10 M	Annual Fee: \$15,125 Tax Rate: \$0.50/SF	Annual Fee: \$50,420 Tax Rate: \$0.50/SF
	\$20 M	Annual Fee: \$30,250 Tax Rate: \$1.01/SF	Annual Fee: \$101,840 Tax Rate: \$1.01/SF
	\$30 M	Annual Fee: \$45,380 Tax Rate: \$1.51/SF	Annual Fee: \$151,260 Tax Rate: \$1.51/SF
	\$40 M	Annual Fee: \$60,505 Tax Rate: \$2.02/SF	Annual Fee: \$201,680 Tax Rate: \$2.02/SF
Square footage of properties with taxable value, excluding less than 20,000 sf (Table A4)	\$10 M	Annual Fee: \$15,840 Tax Rate: \$0.53/SF	Annual Fee: \$52,800 Tax Rate: \$0.53/SF
	\$20 M	Annual Fee: \$31,680 Tax Rate: \$1.06/SF	Annual Fee: \$105,600 Tax Rate: \$1.06/SF
	\$30.M	Annual Fee: \$37,530 Tax Rate: \$1.58/SF	Annual Fee: \$158,400 Tax Rate: \$1.58/SF

Table A2: Annual Flat Rate per Square Foot by Small, Medium, and Large Footage			
		Medium 30,000 Square Feet	Large 100,000 Square Feet
	\$40.M	Annual Fee: \$63,390 Tax Rate: \$2.11/SF	Annual Fee: \$211,300 Tax Rate: \$2.11/SF

A key component that is detailed in **Attachment A** is that the impact of excluding properties that occupy less than 20,000 square feet, approximately 21.1 percent of total square footage area. Excluding businesses that occupy more than 20,000 square feet results in a 26.8 percentage point increase in the annual flat rate. In addition, Table A2 also presents a comparison between total square footage in the City and only taxable square footage, per the data set. The calculation using only taxable square footage increases the annual flat tax rate by 4.7 percent points.

Utility On-Bill Tax (Attachment B)

In the August 16, 2021 City Council meeting, the City Council directed staff to focus pursuit of a utility use-based tax and explore the option to incorporate revenue to support the City's climate adaptability initiative. The City's FY 2022 Adopted Budget includes \$9.7 million for UUT assessed on utility usage and the City's current UUT rate is 5 percent. Significant detail on the options can be found in Attachment B. This attachment discusses two utility tax options, modeled to replace the current gas GFET. Under either option, the current gas GFET would end and potentially be replaced by:

- 1) Increasing or expanding the City's UUT(s) codified in chapter 2.35 of the City's municipal code, which would continue to appear as a line item on utility bills, and
- 2) Modifying the 2009 GFET formula to transfer a percentage of gas utility gross revenues. Under this option, the transfer could be displayed as a separate percentage of retail service charges (as a separate line item on utility bills) or it could be embedded in utility rates.

For additional details, please see **Attachment B**.

Draft Initial Polling Outline (Attachment C)

Staff has engaged with Fairbank, Maslin, Maullin, Metz & Associates (FM3) to design the draft outline for initial polling, expected to be conducted in December 2021. The draft outline includes questions to determine the support for a business tax and the characteristics of it; the willingness to support a utility tax; and questions that test the ranking of funding priorities, with services, infrastructure, and climate action as focus points. The results of the initial poll conducted in January 2020 can be found in [CMR 11019](#).

Conclusion & Next Steps

It is also important to recognize the compressed timeline to bring a ballot measure forward for the November 2022 general election. Further narrowing the focus of the potential revenue generating ballot measure is critical so that staff can continue advancing the Ballot Measure Workplan that was approved by Council in August. Specifically, providing direction on the tax method (parcel tax or business license tax), the desired revenue range that this tax is estimated to generate, and the Finance Committee's direction on the proposed rate for gas utility use-based tax to restore the amount at risk under the *Green* litigation.

This report outlines staff's further research regarding the legal framework surrounding a business license tax using square footage as the unit of measure. Upheld case law regarding the parcel tax method requires that the parcel tax be applied to the entire area that is voting on the measure, which would include residential properties. Options to minimize impact on non-commercial properties include creating a tiered tax that assesses a nominal amount on non-commercial parcels or to institute a separate rebate program that would "refund" residential property owners, as well as any classes/categories designated by the City Council (i.e. small retail and service businesses). The scope and resources to implement a rebate program and yet to be determined. A rebate program would be considerations under the "Administrability" and "Economic Benefits" components of the EASE Framework where the cost of administration and compliance of the tax may be higher and the efficiency of the tax may be lower, due to the potential complexities of a rebate program and need for residents and protected classes/categories must apply for a rebate. Despite these potential challenges, a parcel tax can be assessed on properties that are exempted from ad valorem property tax, including religious, educational, charitable institutions, hospitals, and non-profits entities. Based on work performed by the City's consultant, Matrix Consulting Group, in 2019, the City's largest employers are in the professional services, healthcare, and social assistance ([CMR 10445](#)). While the employee headcount data has most likely changed since pre-pandemic levels, parcel data indicates that the property owners with large footprints within the City may fall into categories that a parcel tax can be legally assessed.

A business license tax has the flexibility to be a general tax, with simple majority passage, or a special tax, with 2/3 approval passage. The City has broad discretion in creating different categories and classes or taxation, variable rates within these categories/classes, or can exempt specific categories/classes, as long as there is a reasonable basis and/or rationale tied with these choices. A business license tax using square footage as the unit of measure would be assessed on the square footage that is being used by the business, therefore there the potential for "square footage leakage" is higher than a parcel tax. For example, in an office complex with a variety of businesses, only the square feet occupied by the business is taxed; common areas such as hallways or a parking lot would not be included in the calculation of the business license tax. Finally, banks and financial institutions, non-profit entities, including medical and educational, are exempt from a business license tax. A key consideration with this legal exemption is although the landowner may be a non-profit entity, the business license tax is

driven by the type of business activity that is conducted in the space, rather than the taxable status of the landowner.

The below table recaps the Ballot Measure Workplan, as approved by the City Council in August.

Table 1: Ballot Measure Workplan Timeline	
October 2021	<p><i>Finance:</i> Accept refined revenue estimates Discuss and provide guidance and initial polling and stakeholder outreach</p> <p><i>Council:</i> Discuss roles of Councilmembers, Community Leaders, and Advocates</p>
November 2021	<p><i>Council:</i> Confirm potential revenue-generating proposals, including revised revenue estimates Direction to complete initial polling and initial stakeholder outreach</p>
December 2021	<p><i>Council:</i> Decision on revenue-generating ballot measure(s) to pursue</p>
January to April 2022	<p><i>Finance and Council:</i> Provide iterative policy decisions and direction based on staff work related to stakeholder outreach, polling, and draft legal documents Second refined round of polling to be reviewed by Finance and Council</p>
May to June 2022	<p><i>Council:</i> Final Approval of November 2022 Ballot Measures, including ballot measure language</p>
August 2022	Language submitted to Santa Clara County Registrar of Voters
November 2022	Election

Consultant support is required to augment staff on topics such as research, modeling and analysis, polling, and stakeholder outreach and eventually drafting ballot measure and ordinance language. Staff expects to return to the City Council for an appropriation request of these funds and approval of consultant contracts, as needed (discussed in the Fiscal/Resource Impact Section).

FISCAL/RESOURCE IMPACT

Implementation of this workplan to develop a revenue generating local ballot measure will require significant resources that include internal staff, consultant expertise, as well as

stakeholder engagement. Resource needs will scale proportionately based on the ballot measure option and the complexity of the measure that the Finance Committee and City Council direct staff to pursue. Therefore, it is important that the scope of the potential ballot measure(s) be clearly defined and effectively narrowed for staff to deploy the appropriate resources to successfully progress through the workplan.

Overall, the City's reduction in workforce has impacted services and operations in the past two fiscal years. It is expected that this initiative will require an equivalent of approximately two full time dedicated staff positions and will have an impact on other projects. In addition, support will be required from outside consultants and engagement with internal stakeholders in key departments. Staff will return to the City Council for appropriation of funds and approval of consultant contracts, as appropriate.

STAKEHOLDER ENGAGEMENT

The Ballot Measure Workplan integrates stakeholder engagement through constituent polling and stakeholder outreach. Staff, throughout the process and from previous conversations, has solicited input and feedback with the Finance Committee, the City Council, residents, and the business community. Based on the Ballot Measure Workplan, staff plans to seek the City Council's direction to complete initial polling and initial stakeholder outreach. The City has engaged with Fairbank, Maslin, Maullin, Metz & Associates (FM3) to develop the draft initial polling outline. The stakeholder outreach strategy has yet to be finalized, as staff is engaging with several revenue measure strategy and communications consulting firms.

ENVIRONMENTAL REVIEW

This activity is not a project under California Environmental Quality Act (CEQA) as defined in CEQA Guidelines, section 15378, because it has no potential for resulting in either a direct or reasonably foreseeable indirect physical change in the environment.

Attachments:

- Attachment A: Preliminary Square Footage Ballot Measure Options
- Attachment B: Preliminary Utility Ballot Measure Options
- Attachment C: Draft Initial Poll Outline
- Attachment D: Summary of Prior Work on Potential Revenue Generating Ballot Measures

ATTACHMENT A

Preliminary Square Footage Ballot Measure Options

Through the City of Palo Alto's conversations exploring a potential business tax, the City Council directed staff to pursue a business tax with the priority of square footage as the basis for such a tax. To date, the City Council has not yet chosen the underlying tax method (i.e. parcel tax or business tax measured by square footage occupied), and there are material differences to different approaches including a different threshold for voter passage and legal guidelines and issues involving each tax method. These specific questions are discussed in detail in this attachment, along with refined tax modeling, as directed by the Finance Committee in the September 21, 2021 meeting. This attachment includes:

- Procedural requirements for parcel taxes and business taxes
- Policy exemption options that consider deference to small businesses based on a minimum threshold of square footage,
- Revised tax model with an updated range of revenue targets (\$10-\$40 million per year) on non-residential square footage,
- Preliminary calculations that show what revenue a potential tax on non-residential square footage could generate in different scenarios

Two Forms of Tax Based on Non-Residential Square Footage: Non-Residential Parcel Tax and Business Tax Measured by Square Footage Occupied

Staff has researched the key features of two types of tax based on non-residential square footage. Relevant information is summarized in *Table A1: Comparison of a Parcel Tax and Business Tax* and discussed below. Both tax methodologies have a fair amount of flexibility in use of revenues. However, there are key differences between these tax methods in two areas: voter approval threshold and tax base/mandatory exclusions. Under a parcel tax, the requirements regarding who may be taxed may pose administrative challenges and is a major policy consideration, as this tax impacts the voter population at large and also the ability to institute a tax with a view towards simplicity.

Table A1: Comparison of Parcel Tax and a Business Tax		
	<i>Parcel Tax</i> <i>(Non-Residential Properties)</i>	<i>Business License Tax, Measured by Square Footage Occupied</i>
Voter Approval Requirement	Requires 2/3 approval, considered to be a special tax	City may elect either: General Tax, simple majority approval – if proceeds are for general City purposes; or Special Tax, 2/3 approval – if proceeds are committed to a defined purpose

ATTACHMENT A

Table A1: Comparison of Parcel Tax and a Business Tax		
	<i>Parcel Tax (Non-Residential Properties)</i>	<i>Business License Tax, Measured by Square Footage Occupied</i>
Requirements Regarding Who May be Taxed	Traditional parcel taxes apply to all parcels within a jurisdiction (though rates may vary by property type). At least one jurisdiction has adopted a parcel tax that applies to a particular property type with the jurisdiction. Staff will provide further information to Council on this issue.	City has broad discretion to define the entities to be taxed, provided that the tax is applied to business activity carried on within the jurisdiction. The City may apply the tax by type or size of locally-present business activity, may create different categories of taxation, may vary rates between categories, or exempt categories, so long as there is some reasonable and rational basis for the categories and distinctions.
Requirements Regarding Use of Proceeds	Parcel taxes are by definition special taxes, meaning that proceeds are dedicated to a defined purpose. The City has discretion to define the purpose narrowly (such as a single service line) or broadly (listing a wide variety of City programs and services)	The City may choose a general tax, which means proceeds are available for any City purpose (with the option that the City Council may indicate by ordinance its intention regarding use of the proceeds), or a special tax, which must be dedicated to a defined purpose.
Mandatory Exemptions	Applies broadly. Property tax exemptions in the California Constitution for religious, educational, and charitable institutions; hospitals; and non-profits entities, are limited to ad valorem taxes and do not apply to locally-adopted parcel taxes. Statutory tax exemptions for banks and financial corporations do not apply to property taxes, including locally-adopted parcel taxes.	Banks and financial corporations are exempt from this type of local tax (Cal. Rev. & Tax. Code §23182); non-profit entities, including medical and educational institutions, are also exempt (Cal. Rev. & Tax. Code § 7284.1)

ATTACHMENT A**Parcel Tax**

Since it is a tax on a property, a parcel tax must be considered as a special tax and requires 2/3 voter approval. Definition of the use of revenue can be scaled to be very narrow, listing one or two lines of service or capital investment needs, or very broad, listing many lines of service and general capital investment needs. Constitutional exemption from ad valorem property tax for religious, educational, charitable institutions, hospitals, and non-profit entities, does not apply to a parcel tax. Statutory exemption from local taxation for banks and financial corporations also does not apply to a parcel tax.

Traditional parcel taxes apply broadly to parcels within the jurisdiction, though rates may vary by property type. Recently, at least one jurisdiction has adopted a parcel tax that applies only to certain commercial parcels within the jurisdiction. Staff will provide further confidential advice on this issue.

Parcel categories and descriptions (driven by “use codes”) provide a limited range of categories, therefore the ability to craft specific policy exemptions is finite. A second, more broad option that considers potential protection/deference to small retail and services, would be the development of separate business support program that could assist small retail and services that lease commercial space and may be exposed to landlords who pass on the tax. This option requires further exploration by staff, including potential structure, guidelines, and process and budgetary resources required to administrate the program. These resources would be scaled based on the complexity of the program.

Unlike a business license tax, a parcel tax would apply to religious, educational, charitable institutions, hospitals, and non-profits; the ad valorem property tax exemptions permitted to these entities do not apply to a parcel tax. Banks and financial corporations would also be subject to a parcel tax.

Business License Tax

Although the more common business tax unit of measure is the gross receipts method, a business tax using square footage of the business is allowed under California law. The California Government Code and the Business Professions Code, authorize local governments, including charter cities, to impose a business license tax based on a unit of measure that fairly reflects the proportion of the taxed activity carried on within the taxing jurisdiction. An example of a nearby municipal agency that assesses a business license tax based on the square footage unit of measure is the City of Cupertino. A business license tax can be structured as a general tax, requiring a simple majority for passage, or a special tax, requiring 2/3 majority approval for passage. This distinction is based on whether revenues generated from the tax will be used for general government purposes or will be restricted in any way, which would designate the tax as a special tax.

Unlike a parcel tax, banks and financial institutions and non-profit entities, including medical and educational institutions, are exempt from a business license tax. Compared to a parcel tax,

ATTACHMENT A

the business license tax methodology provides more flexibility and broad discretion to create different categories of entities to be taxed, provided that there is some reasonable and rational basis for these categories and distinctions. For example, if the Council wishes to exempt small retail and service businesses, the ballot measure language would include language defining these categories and classes. This approach poses substantially less administrative burden in assessing the tax.

Revised Calculations of Revenue Generated by a Square Footage Tax

Based on available data detailed later in this report, non-residential square footage varies between the total 25.140 million square feet of non-residential space in the City of Palo Alto (Table A3) and 24.003 million square feet for properties with taxable value (Table A4). The calculation of taxable square footage likely reflects the available square footage for a business tax and models the annual rates necessary to reach different revenue targets identified by the City Council, before any exemptions are assumed. It is critical to understand that these very calculations that are modeled using parcel data and are driven by property owner data and categories designated by the County of Santa Clara, therefore the categories described in staff's models does not necessarily correlate to the business activity performed in the space.

These models are derived from simple mathematical calculations from parcel data as described. Rates and impacts will change based on the methodology selected (parcel tax versus business tax) and any policy exemptions that are selected by the City Council. Should the City Council choose to include additional exceptions under the business license tax methodology rate, an adjusted increase by a corresponding amount would be required to capture the desired level of revenue. If a parcel tax is selected, the option to protect certain business categories would be implemented via a separate business support program, as described earlier in this attachment.

During earlier conversations with the City Council and Finance Committee regarding development of a potential business tax, there was significant interest, and direction, by the City Council to exempt small businesses. The impact of excluding properties less than 20,000 square feet, which account for approximately 21.1 percent of total square footage area, is presented in Table A2. Excluding businesses that occupy more than 20,000 square feet results in a 26.8 percentage point increase in the annual flat rate compared to a tax rate applied to all square footage.

In addition, Table A2 also presents a comparison between total square footage in the City and only taxable square footage, per the data set. The calculation using only taxable square footage results in a 4.7 percentage point increase in the annual flat tax rate.

Based on the Finance Committee's direction, staff has modeled a variety of scenarios that include the Finance Committee revised revenue range target, \$10-\$40 million in tax revenue annually.

ATTACHMENT A

Table A2: Annual Flat Rate per Square Foot by Small, Medium and Large Footage				
		Small 2,500 Square Feet	Medium 30,000 Square Feet	Large 100,000 Square Feet
Types of Businesses		Cafes/coffee shops, small local/neighborhood businesses and shops, small commercial	Office buildings, retail, specialty shopping centers, service stations	International Hotel Brands, manufacturing
Total Square Footage in City (Table A3)	\$10 M	Annual Fee: \$995 Tax Rate: \$0.40/SF	Annual Fee: \$11,940 Tax Rate: \$0.40/SF	Annual Fee: \$39,800 Tax Rate: \$0.40/SF
	\$20 M	Annual Fee: \$1,990 Tax Rate: \$0.80/SF	Annual Fee: \$23,880 Tax Rate: \$0.80/SF	Annual Fee: \$79,600 Tax Rate: \$0.80/SF
	\$30 M	Annual Fee: \$2,985 Tax Rate: \$1.20/SF	Annual Fee: \$35,820 Tax Rate: \$1.20/SF	Annual Fee: \$119,400 Tax Rate: \$1.20/SF
	\$40 M	Annual Fee: \$3,980 Tax Rate: \$1.60/SF	Annual Fee: \$47,735 Tax Rate: \$1.60/SF	Annual Fee: \$159,110 Tax Rate: \$1.60/SF
Square footage of properties with taxable value (Table A4)	\$10 M	Annual Fee: \$1,045 Tax Rate: \$0.42/SF	Annual Fee: \$12,50 Tax Rate: \$0.42/SF	Annual Fee: \$41,660 Tax Rate: \$0.42/SF
	\$20 M	Annual Fee: \$2,085 Tax Rate: \$0.83/SF	Annual Fee: \$24,995 Tax Rate: \$0.83/SF	Annual Fee: \$83,320 Tax Rate: \$0.83/SF
	\$30 M	Annual Fee: \$3,125 Tax Rate: \$1.25/SF	Annual Fee: \$37,495 Tax Rate: \$1.25/SF	Annual Fee: \$124,980 Tax Rate: \$1.25/SF
	\$40 M	Annual Fee: \$4,165 Tax Rate: \$1.67/SF	Annual Fee: \$49,995 Tax Rate: \$1.67/SF	Annual Fee: \$166,645 Tax Rate: \$1.67/SF
Total Square Footage in City, excluding less than 20,000 sf (Table A3)	\$10 M	N/A	Annual Fee: \$15,125 Tax Rate: \$0.50/SF	Annual Fee: \$50,420 Tax Rate: \$0.50/SF
	\$20 M	N/A	Annual Fee: \$30,250 Tax Rate: \$1.01/SF	Annual Fee: \$101,840 Tax Rate: \$1.01/SF
	\$30 M	N/A	Annual Fee: \$45,380 Tax Rate: \$1.51/SF	Annual Fee: \$151,260 Tax Rate: \$1.51/SF
	\$40 M	N/A	Annual Fee: \$60,505 Tax Rate: \$2.02/SF	Annual Fee: \$201,680 Tax Rate: \$2.02/SF
Square footage of properties with taxable value, excluding less than 20,000 sf (Table A4)	\$10 M	N/A	Annual Fee: \$15,840 Tax Rate: \$0.53/SF	Annual Fee: \$52,800 Tax Rate: \$0.53/SF
	\$20 M	N/A	Annual Fee: \$31,680 Tax Rate: \$1.06/SF	Annual Fee: \$105,600 Tax Rate: \$1.06/SF
	\$30 M	N/A	Annual Fee: \$37,530 Tax Rate: \$1.58/SF	Annual Fee: \$158,400 Tax Rate: \$1.58/SF
	\$40 M	N/A	Annual Fee: \$63,390 Tax Rate: \$2.11/SF	Annual Fee: \$211,300 Tax Rate: \$2.11/SF

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As in the legal framework section of this attachment, a business tax would have necessary exemptions by state and federal statute and would therefore shrink the available square footage that a tax could be assessed on, resulting in corresponding increases to the rates. In addition, parcel data is limited to categories designated by the County of Santa Clara and does not necessarily correlate to the type of business activity that is conducted on the property.

Review of Available Square Footage Data

Through conversations with the City's property tax consultant, Coren and Cone (an HdL company), the City procured parcel information for properties within the City of Palo Alto. This includes a breakdown of the categorization of the parcel, such as commercial or industrial, as well as the taxable valuation of the property, parcel square footage, and building square footage. The data set is generally consistent with information previously presented to the City Council as part of [CMR 10445](#), which detailed approximately 25.8 million square feet of non-residential space available for rent in the City of Palo Alto.

Although this data set is generally consistent with the information previously presented to the City Council, staff has identified gaps in the data set. Notably, 746 of 20,933 parcels (or approximately 3.5 percent) did not include building square footage data. For example, many of Stanford's properties do not list a building square footage, including both the new 824,000 square foot hospital finished in November 2019 and the 521,000 square foot Lucille Packard Children's Hospital completed in 2017. The preliminary tables and calculations in this report will be further refined as the process continues and the conversation narrows and focuses. Staff will be able to prioritize resolving gaps in the data consistent with City Council's direction on next steps. Given the lack of information on building square footage from various parcels – including many owned by Stanford – the differences between the base calculation and the exclusion of those with a taxable assessed value of zero is likely lower than it will be in later calculations.

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Table A3: Total Square Footage by Size by Category

Size	Commercial	Govt. Owned	Industrial	Inst.	Misc.	Rec.	Vacant	Grand Total	% of Total	Running %
1 - 2,000	163,025	-	2,910	6,436	784	1,980	28,485	203,620	0.8%	
2,001 - 5,000	886,416	-	119,663	6,539	-	13,563	39,257	1,065,438	4.2%	5.0%
5,001 - 8,000	905,355	-	138,249	6,420	-	21,126	6,112	1,077,262	4.3%	9.3%
8,001 - 12,000	926,898	10,120	226,735	11,392	11,786	-	-	1,186,931	4.7%	14.1%
12,001 - 16,000	639,260	29,112	202,324	27,791	-	29,042	-	927,529	3.7%	17.7%
16,001 - 20,000	664,726	-	181,080	-	-	-	-	845,806	3.4%	21.1%
20,001 - 40,000	1,991,079	-	499,571	23,276	-	153,046	-	2,666,972	10.6%	31.7%
40,001 - 75,000	1,971,313	-	677,243	109,528	-	-	-	2,758,084	11.0%	42.7%
75,001 - 100,000	1,234,293	75,045	859,708	-	-	-	-	2,169,046	8.6%	51.3%
100,001 - 200,000	3,579,181	-	262,125	-	-	-	-	3,841,306	15.3%	66.6%
200,001 - 300,000	1,977,847	-	628,724	-	-	-	-	2,606,571	10.4%	77.0%
300,001 - 500,000	458,842	-	1,047,936	-	-	-	-	1,506,778	6.0%	83.0%
500,001 - 750,000	675,100	-	1,169,927	-	-	-	-	1,845,027	7.3%	90.3%
750,000 – 1.5 M	1,395,540	-	1,043,988	-	-	-	-	2,439,528	9.7%	100.0%
Total	17,468,875	114,277	7,060,183	191,382	12,570	218,757	73,854	25,139,898		
% of Total	69.5%	0.5%	28.1%	0.8%	0.1%	0.9%	0.3%			

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Table A4: Square Footage by Size by Category – Only Properties with Taxable Value

Size	Commercial	Govt. Owned	Industrial	Inst.	Misc.	Rec.	Vacant	Grand Total	% of Total	Running %
1 -2,000	163,025	-	2,910	2,508	784	1,980	28,485	199,692	0.8%	
2,001 - 5,000	870,322	-	119,663	-	-	10,514	39,257	1,039,756	4.3%	5.2%
5,001 - 8,000	880,358	-	138,249	-	-	21,126	6,112	1,045,845	4.4%	9.5%
8,001 - 12,000	889,309	10,120	226,735	-	11,786	-	-	1,137,950	4.7%	14.3%
12,001 - 16,000	600,507	14,640	202,324	27,791	-	29,042	-	874,304	3.6%	17.9%
16,001 - 20,000	594,262	-	181,080	-	-	-	-	775,342	3.2%	21.1%
20,001 - 40,000	1,884,014	-	499,571	23,276	-	90,546	-	2,497,407	10.4%	31.5%
40,001 - 75,000	1,929,883	-	604,547	59,820	-	-	-	2,594,250	10.8%	42.3%
75,001 - 100,000	1,234,293	-	687,008	-	-	-	-	1,921,301	8.0%	50.4%
100,001 - 200,000	3,459,198	-	262,125	-	-	-	-	3,721,323	15.5%	65.9%
200,001 - 300,000	1,977,847	-	427,029	-	-	-	-	2,404,876	10.0%	75.9%
300,001 - 500,000	458,842	-	1,047,936	-	-	-	-	1,506,778	6.3%	82.2%
500,001 - 750,000	675,100	-	1,169,927	-	-	-	-	1,845,027	7.7%	89.8%
750,000 – 1.5 M	1,395,540	-	1,043,988	-	-	-	-	2,439,528	10.2%	100.0%
Total	17,012,500	24,760	6,613,092	113,395	12,570	153,208	73,854	24,003,379		
% of Total	70.9%	0.1%	27.6%	0.5%	0.1%	0.6%	0.3%			

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Preliminary Utility Ballot Measure Options

The City Council has directed staff, through the City of Palo Alto's conversations exploring a potential business tax, to pursue a utility users tax (UUT) and to explore the option to generate revenue to support the City's climate adaptability goals. This attachment transmits analysis related to a potential ballot measure to further the Finance Committee and City Council's conversations on this issue. In addition to potentially increasing the City's utility users tax, currently set at 5 percent, there are a variety of alternatives that the Finance Committee and City Council can consider in structuring such a tax, each of which relate to the broader question of whether and how to modify or replace the Council-adopted General Fund Equity Transfer (GFET) methodology.

At the September 21, 2021 Finance Committee meeting, the Committee directed staff to model a UUT increase applied to retail gas service charges to restore the amount at risk in the *Green v City of Palo Alto*, a class action lawsuit which challenged the City's gas and electric rates under Proposition 26. In *Green*, the trial court judge found that the City's electric rates are valid, but the City's gas rates include an element of tax requiring voter approval under California's Proposition 26 because they are set at a level sufficient to fund an annual transfer of approximately \$7.7 million to the City's General Fund. Last month, City Council authorized an appeal to seek guidance from the Court of Appeal on a variety of legal questions that will impact Palo Alto and, potentially, municipal utilities across California.

The GFET is included in the City's utility rate model as an expense. With respect to electricity, the utility generates sufficient revenue from sources other than rate payers to pay for the GFET. Therefore, the electric GFET does not impact rates. With respect to gas, the GFET impacts the utility rate. The *Green* litigation has shifted the City's FY 2022 financial balancing strategy and has potentially significant, long-term budgetary impacts to the City's General Fund. If the gas GFET is excluded from Palo Alto's utility rate model, based on the FY 2022 Adopted Budget, approximately \$7.4 million would no longer be transferred to the General Fund and would remain with the City's gas enterprise, reducing gas rates. Finance Committee and City Council direction is needed on whether to seek to recover for the General Fund an equivalent amount, or some portion of the total, via a modified voter-approved GFET, an increase or expansion of the current 5 percent UUT, or some combination of both.

This attachment discusses two utility tax options, modeled to replace the current gas GFET. Under either option, the current gas GFET would end and potentially be replaced by:

- 1) Increasing or expanding the City's UUT(s) codified in chapter 2.35 of the City's municipal code, which would continue to appear as a line item on utility bills, and
- 2) Modifying the 2009 GFET formula to transfer a percentage of gas utility gross revenues. Under this option, the transfer could be displayed as a separate percentage of retail service charges (as a separate line item on utility bills) or it could be embedded in utility rates.

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This attachment also includes discussion of the following topics that were included in [CMR 13514](#), Attachment B. Staff has included once again for ease of reference:

- Climate adaptability options that includes impact on current rates and estimated generated revenue to support this initiative;
- General Fund Equity Transfer Methodology
- Review of EASE framework as it pertains to utility users tax;
- Utility user tax rates for cities in Santa Clara County and San Mateo County.

Potential Modifications to the City's Gas Utility Users Tax, Chapter 2.35 of the Municipal Code

UUTs are very common across California, with the vast majority structured to create general fund revenue with majority voter approval. Roughly half of California residents and businesses pay a UUT. Enacted in 1987, the City's UUTs are applied to electricity, water and gas usage as well as telephone service. The tax rate applied to utilities is five percent.

Replacing the amount of the gas GFET, approximately \$7.7 million annually (based on staff's forecast beyond this budget year), would result in a 32 percent gas UUT rate, made up of a 27 percent tax to replace the gas GFET plus the current 5 percent rate. Staff estimates that for every 1 percent increase to the gas UUT rate, an additional \$284,000 in UUT revenue would be generated. This calculation is based on estimated sales activity and utility rates in the FY 2022 Adopted Budget.

If the \$7.7 million was collected via the gas, electric, and water UUTs, the resulting rate would be 9 percent, an addition of 4 percent over the current 5 percent rate. Additionally, if the amount was collected from all of the City's utilities (gas, electric, water, wastewater, refuse, storm drain, and fiber), the resulting UUT rate would be 7 percent, a two percent increase over the current UUT rate.

Table B1: Modification to City's Utility Users Taxes (Based on FY 2022 Budget and Rates)			
	<i>Gas</i>	<i>Gas, Electric, Water</i>	<i>Gas, Electric, Water, Wastewater, Refuse, Storm, Fiber</i>
Estimated UUT	32%	9%	7%
Additional Revenue Generated by each 1% UUT change	\$284,000	\$1,910,000	\$2,475,000

Under this approach, the amount of gas GFET currently collected via the City's gas utility rates would end, resulting in a lower average gas bill. Table B2 outlines the decrease for residential and commercial gas customers, based on rates that are effective December 2020. The average

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monthly gas residential bill would decrease from \$45 to \$37, which is 30 percent lower than PG&E's rates.

Table B2: Gas Residential and Commercial Monthly Bill Comparisons								
Type	Usage level (therms)	Palo Alto	PG&E	\$ Difference	% Difference	Palo Alto Excluding Gas GFET	\$ Difference	% Difference
Residential	Median**	\$45	\$53	(\$8)	-14%	\$37	(\$16)	-30%
Commercial	500	\$685	\$718	(\$33)	-5%	\$562	(\$156)	-22%
Commercial	5000	\$5,986	\$6,831	(\$845)	-12%	\$4,909	(\$1,922)	-28%
Commercial	10000	\$11,875	\$12,045	(\$170)	-1%	\$9,738	(\$2,308)	-19%
Commercial	50000	\$59,005	\$51,419	\$7,586	15%	\$48,384	(\$3,035)	-6%

If the City opts to increase the water UUT or impose a new UUT for wastewater or storm drain services, there is some risk of legal challenge. Recently, plaintiffs challenged the City of Long Beach's 12 percent tax on its water and wastewater utilities, claiming that UUTs on services other than electric and gas are either invalid, or require 2/3 voter approval, as special taxes based on an incident of property ownership (here, on utility services).¹ Fees for gas and electric service, however, are exempt from the California constitution's definition of property-related fee, and Long Beach's gas UUT was not part of this challenge.²

Long Beach is currently appealing this litigation, and if Long Beach loses its appeal, the result could produce a split of authority at the appellate level which would require Supreme Court review to resolve.³ While it seems unlikely that a court would strike the legal foundation for hundreds of existing UUTs statewide, the City Attorney's office is monitoring this case closely. This case is just one example of the variety of legal theories and voter initiatives being advanced in this area of municipal finance law.⁴

Potential Voter Approval of Percentage of Gross Utility Revenues

Another option is to leave the current UUT intact and seek voter approval to simplify the 2009 GFET methodology to impose a flat tax on gross utility revenues. The flat tax could be displayed separately on the customer's bill or be embedded in rates. Collecting the projected annual \$7.7 million gas transfer via this method would reduce gas utility rates (as shown in Table B2) and

¹ The challenge was premised on language in Article XIII D, section 3 of the California Constitution, added by Proposition 218 in 1996, which lists 4 types of valid taxes, assessments and fees, including special taxes receiving a 2/3 vote, and "fees or charges for property related services".

² See Article XIII D, section 3 of the California Constitution: "For purposes of this article, fees for the provision of electrical or gas service shall not be deemed charges or fees imposed as an incident of property ownership."

³ *Kimball, et. al. v. City of Long Beach* (Case No. B305134, appeal pending).

⁴ On October 1, 2021, a Sacramento law firm submitted a proposed ballot measure to the Secretary of State, the "Taxpayer Protection and Government Accountability Act", which could bar the use of utility rate proceeds for general fund purposes, even with voter approval. The measure could invalidate some voter-approved taxes imposed after Oct 1, 2021 but prior to the measure's effective date.

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add a gross gas revenues tax of approximately 24 percent. Embedding the amount of the tax within the utility's cost of providing service would not require a change in utility rates and is consistent with how the GFET is collected now. Both options would require voter approval.

Several other cities with municipal utilities, including Burbank, Colton, Pasadena and Sacramento, structure their annual utility transfers as a percentage of gross revenues, which is then covered by utility revenues as a cost of providing service. Cities have been challenged over this practice, and this area of the law remains in flux. However, California's Court of Appeal recently upheld Sacramento and Pasadena's voter-approved general fund transfer taxes, which were structured as an 11 percent and 12 percent tax, respectively, on the gross revenues of Sacramento's and Pasadena's city-operated utility enterprises.⁵ Each of these taxes are embedded in the cost of providing utility services, and are not identified as a separate line item on the customer's utility bills.

Climate Adaptability Funding Options

In the August 16, 2021 City Council meeting, the City Council directed staff to focus pursuit of a utility use-based tax and explore the option to incorporate revenue to support the City's climate adaptability initiative. The City's FY 2022 Adopted Budget includes \$9.7 million for UUTs assessed on utility usage for electric, gas, and water; the City's current UUT rate is 5 percent. Staff estimates that a 1 percent increase to the UUT rate, for both gas and electric, is estimated to yield an additional \$2 million in UUT revenue in the General Fund, while a 1 percent increase in the gas utility only is estimated to yield \$284,000. These calculations are based on sales activity and utility rates in the FY 2022 Adopted Budget. To illustrate, if the desired total UUT revenue is \$30 million, a \$20 million increase above the FY 2022 Adopted Budget, then the UUT rate, if applied to gas, electric, and water, would be approximately 15 percent, an additional 10 percent on top of the current 5 percent rate.

Furthermore, based on the City's Sustainability and Climate Action Plan (S/CAP) and the plan's goal to reduce natural gas usage, in applying the EASE Framework, the long-term stability of this revenue source decreases over time. Staff has included Chart B1, Forecast Gas Consumption, that was included in the Gas Utility Financial Plan ([CMR 12240](#)). This chart is a baseline forecast used for utility rate modeling and does not include reductions resulting from S/CAP key actions (i.e. approximately a 7 percent decrease from 2020 to 2030), which would further reduce revenue generated from a potential ballot measure. Further analysis by staff would have to be done to calculate the potential estimated impacts of the City's S/CAP goals in reducing use of natural gas and the impacts to potential utility tax to recover the amount of the gas GFET.

⁵ *Wyatt v. City of Sacramento*, (2021) 60 Cal.App.5th 373; *Komesar v. City of Pasadena* (2021, Case No. B314666).

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Review of the Equity, Administrability, Stability, and Economic Benefits (EASE) framework for a Utility Based Tax

The City Council and Finance Committee have used the EASE framework as the main means of evaluating potential tax ballot measures. A review of the EASE frameworks for both the UUT and tax on utility gross revenues is presented in Table B1 below.

Table B3. EASE Framework for Utility Users Tax		
	Utility Users Tax	Tax on Utility Gross Revenues
Equity	<p>Utility Users Tax is a flat rate tax imposed on the charges made for metered utility and charges for service (includes customer charges, service charges, standby charges, charges for temporary services, demand charges, and annual and monthly charges.</p> <p>This tax is considered a proportional tax, a tax that takes the same percentage from all groups, since the flat tax rate is assessed based on the customer bill, the amount of tax paid by a customer directly correlates to the amount of utility commodity that is used.</p>	<p>This tax can be a flat rate assessed on gross utility revenues (includes customer charges, service charges, standby charges, charges for temporary services, demand charges, and annual and monthly charges.</p> <p>Similar to the UUT, this tax is considered a proportional tax, a tax that takes the same percentage from all groups, since the flat tax rate is assessed based on the customer bill, the amount of tax paid by a customer directly correlates to the amount of utility commodity that is used.</p>
Administrability	<p>This tax is administrated through the City's Utility Billing system and appears monthly on customer bills. The cost for administrating this tax is assumed in the City's Utility Department budget and is supported internally by City staff.</p>	

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Table B3. EASE Framework for Utility Users Tax

Stability	<p>The City's Sustainability and Climate Action Plan outlines a variety of work plan items that makes progress towards reducing the City's carbon impacts, greenhouse gas emissions, and resource consumption. Changes in resource consumption, particularly for gas will have a direct impact on the amount of UUT revenue collected by the City in the long term. The City's Sustainability and Climate Action Plan (S/CAP) update project includes a draft Three-Year Workplan that focuses on reducing use of natural gas that will impact the ability to generate revenues to restore the amount at risk from the <i>Green</i> litigation.</p> <p>In addition to the long-term reduction of gas use, month to month gas commodity costs and usage vary and although the market price of gas has dropped over the past decade, these variables may have a long-term stability of this tax revenue source if applied to gas utility usage. See below charts, excerpted from the Gas Utility Plan that was presented to the City Council in April 2021 (CMR 12240, Gas Utility Financial Plan)</p>
Economic Benefits	<p>This tax may deter certain business industries that have heavy resource consumption (i.e. industrial, manufacturing). Weighing this impact against the overall lower utility rates, specifically if utility rates are adjusted downward for the General Fund Equity Transfer, will offset this impact. Payment of the tax for customers is incorporated into the customer's monthly bill; the seamless administration of this tax minimizes disruption for the taxpayer.</p>

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Chart B1: Forecast Gas Consumption

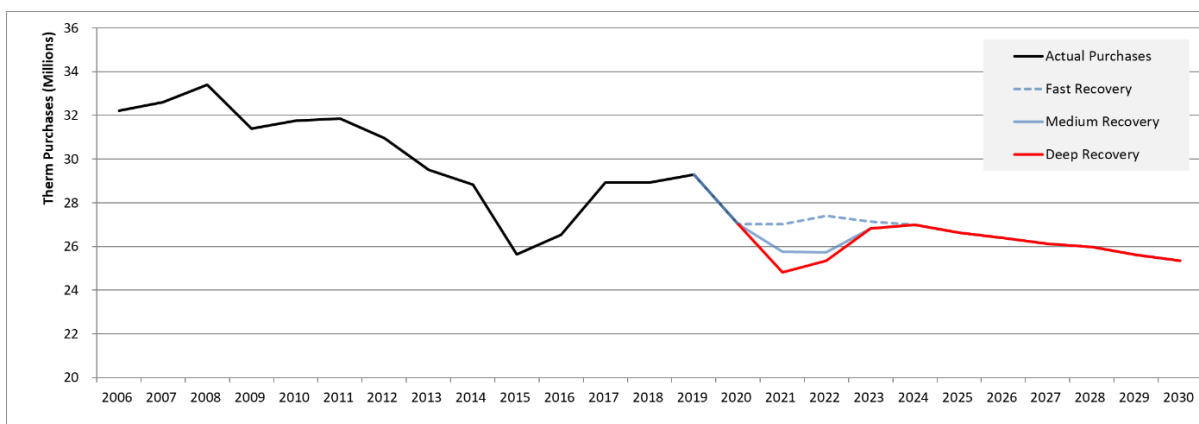


Chart B2: Gas Commodity Rates from July 2012 through January 2021



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Utility User Tax Rates for Cities in Santa Clara County and San Mateo County

The Utility User Tax rates for cities in San Mateo County and Santa Clara County are listed in Table B4, A comparison of Local Utility User Tax Rates obtained from the California State Controller. Average UUT rates in the region fall between 2 percent (City of Sunnyvale) and 6.5 percent (City of Pacifica). The City's 5 percent rate falls within the overall average of the region.

Table B4. Comparison of Local Utility User Tax Rates

	Electric		Gas	
	Residential	Commercial	Residential	Commercial
San Mateo County				
Daly City	5.0%	5.0%	5.0%	5.0%
East Palo Alto	5.0%	5.0%	5.0%	5.0%
Menlo Park	3.5%	3.5%	3.5%	3.5%
Pacifica	6.5%	6.5%	6.5%	6.5%
Portola Valley	4.5%	4.5%	4.5%	4.5%
Redwood City	5.0%	5.0%	5.0%	5.0%
	Electric		Gas	
	Residential	Commercial	Residential	Commercial
Santa Clara County				
Cupertino	2.4%	2.4%	2.4%	2.4%
Gilroy	5.0%	5.0%	5.0%	5.0%
Los Altos	3.5%	3.5%	3.5%	3.5%
Mountain View	3.0%	3.0%	3.0%	3.0%
Palo Alto	5.0%	5.0%	5.0%	5.0%
San Jose	5.0%	5.0%	5.0%	5.0%
Sunnyvale	2.0%	2.0%	2.0%	2.0%

Source: California State Controller, Cities Annual Reports

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In addition to the information discussed earlier in this staff report, below is staff's research of several pertinent utility tax measures in California, including the ballot questions, rate, and passage rates.

City	Ballot Question	Ballot Measure	Rate	Date	Approved?
City of Anaheim	Shall Section 1221 of the Anaheim City Charter regarding water and electric rates be amended to: update language regarding financial reserves, reaffirm and authorize the transfer of money to the City's general fund to support general City services, remove unnecessary language that duplicates a requirement of the California Constitution, and authorize programs to assist non-residential and residential customers?	Measure N	Rates shall be sufficient to pay basic expenses, as well as (Sec 1221(e)): 4% of operating revenue earned by water and electric utilities during prior fiscal year. Sec 1221 also put ratepayer discounts and customer assistance programs in the Charter, to be paid from rates.	Nov. 2014	Defeated. No: 50.1% Yes: 49.9%
City of Banning	To allow approximately \$2,325,000 annually for unrestricted general revenue purposes such as police, fire, paramedics, parks, and senior services while stabilizing electric utility rates, shall an ordinance be adopted authorizing a transfer not to exceed 7.5% of annual electric utility gross revenues to the City's General Fund until December 1, 2021 and 5.5% thereafter, for unlimited duration, and establishing a rate freeze for 3 years, except as needed for financial emergency or bond covenants?	Measure P	Transfer 7.5% of annual electric utility gross revenues to General fund until Dec. 1, 2021, and 5.5% thereafter, and setting a rate freeze for 3 years, except for emergencies.	Nov. 2018	Defeated. No: 51.29% Yes: 48.71%
City of Burbank	To maintain essential City services/infrastructure like police, fire, parks, libraries, streets and street lighting, shall the measure be adopted amending the City of Burbank Charter to continue the past practice of transferring not more than 7% of Burbank Water and Power's gross annual sales of electricity, paid by retail electric rate payers, providing approximately \$12.5 million annually to the City's General Fund until ended by voters, with all money spent to benefit Burbank residents?	Measure T	7% of gross annual electricity sales paid by retail rate payers, as a separate line item on the bill or embedded within rates and applied retroactively to 2016/17 fiscal year.	June 5, 2018.	Approved. Yes: 81.1% No: 18.9%

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City	Ballot Question	Ballot Measure	Rate	Date	Approved?
City of Colton	To add approximately \$4,800,000 in funding annually for general city services such as police, fire, paramedics, parks, libraries and senior services while stabilizing electric utility rates; shall an ordinance be adopted authorizing a transfer not to exceed 20% of annual electric utility gross revenues to the City's General Fund reverting back to a 12.39% maximum on June 30, 2021, and establishing a freeze on electric utility rates for 5 years, except in cases of financial emergency?	Measure D	20% of Electric Utility's prior year gross revenues for 5 years.	June 2016	Approved. Yes: 76.2% No: 23.8%
City of Pasadena	Shall the measure maintaining 911 response, fire, paramedic, public health, senior and homeless services, street repairs, and other services by amending the City Charter to continue collecting in electric rates and maintain the longstanding transfer, limited to 12% gross revenue, providing \$18,000,000 annually to Pasadena's General Fund that does not increase taxes or utility rates until ended by voters, requiring financial audits with all funds locally controlled benefitting Pasadena residents, be adopted?	Measure P	12% of gross revenue of electric utility.	Nov. 3 2020	Approved: Yes: 83.57% Challenged in <i>Komesar v. City of Pasadena</i> , upheld.
City of Sacramento	In order to comply with Prop 218 ... shall the City of Sacramento replace its current in-lieu franchise and property tax fees on water, sewer, drainage and garbage with a general tax which will not result in any changes to existing city utility rates??	Measure I	Tax of 11 percent on gross revenues from user fees & charges imposed by city enterprises providing water, sewer, storm drainage, & solid waste services	June 1998	Approved: Yes: 54.4% Challenged in <i>Wyatt v. City of Sacramento</i> , upheld.

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OPINION
RESEARCH
& STRATEGY

TO City of Palo Alto Staff and Council

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FM3 Research

RE: Ballot Measure Survey Outline

DATE October 8, 2021

This memo outlines our recommended approach for the Palo Alto ballot measure structure survey, anticipating a potential business tax measure in November 2022. This survey is structured to update baseline attitudes about City government and issues of concern by re-asking about those topics in the same we have in prior years. It then moves into design of a potential business tax measure: asking about general support for additional revenue, then about potential mechanisms, project priorities for new funding, and preferences on measure structure. Voters will also hear an exchange of pros and cons, modeling in brief the impact of "yes" and "no" campaigns. They will also be briefly asked about a measure dealing with an equity transfer from the utility fund.

- Survey introduction
- Cell or landline, safety check
- Right direction/wrong track (tracking to prior years)
- Job rating - Palo Alto city government (tracking to prior years)
- Approval rating on specific aspects of City management (tracking most to prior years)
 - Maintaining infrastructure
 - Managing budget/finances
 - Affordable housing
 - Using tax dollars efficiently
 - Transportation
- Need for additional funding (tracking to prior years)
- Need for additional funding to maintain and improve infrastructure (tracking to prior years)
- Problem seriousness battery (tracking most to prior years)
 - Parking
 - Affordable housing and housing costs
 - Cost of living
 - The impacts of the coronavirus (economic and public health, or more general)
 - Climate change

ATTACHMENT C



- Wildfire and/or smoke/air pollution
- Waste and inefficiency in local government
- Condition of the local economy
- Crime
- Unhoused population / Homelessness
- Traffic
- Growth and development
- Local tax rates
- Changing character of the community
- Airplane noise
- Caltrain electrification/crossings
- General support for or opposition to a business tax -- either split sampling or rotating
 - Parcel tax
 - Business license tax
- Open-ended question on reason for support/opposition
- Importance of potential projects/priorities, with variations in wording (tracking many to prior years)
 - Infrastructure
 - Streets/roads
 - Traffic congestion and parking
 - Access for people with disabilities
 - Affordable housing
 - Unhoused / Homelessness
 - Operating hours for park, recreation, and community facilities
 - Caltrain electrification/crossings
 - Police and fire services
 - Library services
 - Shuttle programs
 - Sustainability and climate action plan goals
- Should authority be delegated to City Council to decide on components such as length and exemptions?
- Support for or opposition to business tax components
 - Rate
 - Tax structure, e.g. parcel tax or business tax
 - How it is calculated, e.g. square footage, number of employees or payroll
 - Potential exemptions
 - Sunset or length
 - CPI and escalators

ATTACHMENT C



- Arguments in support of a measure, such as:
 - Fairness
 - Specific uses of the tax
 - Need for stability in funding
- Re-vote
- Arguments opposing a measure, such as:
 - Too many taxes/cost of living
 - Potential for government waste/mismanagement
 - Hurts local businesses during economic recovery from COVID
- Final vote
- General support for or opposition to a utility tax - either split sampling or rotating
 - Assessed on gas, electric, and water usage
 - Assessed on only gas usage
- Demographics
 - Work in Palo Alto
 - Own a business in Palo Alto
 - Education
 - Ethnicity
 - Income
 - Gender
- Voter file information (will not need to ask this)
 - Party
 - Age
 - Past election participation

ATTACHMENT D

Summary of Prior Work on Potential Revenue Generating Ballot Measures

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](#)

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1/27/2020 City Council, “Update, Consideration, and Potential Direction on Possible Local Tax Measure for 2020 Election”, [CMR 11019](#)

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](#)

6/15/2021, Finance Committee Staff Report, “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”, [CMR 12299](#)

8/16/2021 City Council, “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 Funds as Referred by the City Council”, [CMR 12381](#)

9/21/2021 Finance Committee Staff Report, “Discuss Updates and a Recommended Further Refinement of Potential Revenue Generating Local Ballot Measures,” [CMR 13514](#)