

COUNCIL MEETING

11/08/2021

Received Before Meeting

13

POTENTIAL REVENUE GENERATING LOCAL BALLOT MEASURE

Updates, Further Refinement & Draft Outline for Initial Polling

November 8, 2021

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- Tonight, we continue the exploration of a potential business tax and/or utility use-based tax as potential revenue-generating local ballot measures for the November 2022 Election.
- **Provide direction to Staff on:**
 - **Further narrowing of a business license tax, including industry exemptions, possible business size thresholds, and other components (sunset, escalator)**
 - **Modeling approach for a measure to replace at-risk General Fund equity transfer**
 - **Feedback on initial polling to inform whether one or more taxes may be feasible on the 2022 ballot, particularly polling regarding exemptions and uses of revenue. Direct staff to execute initial round of polling.**

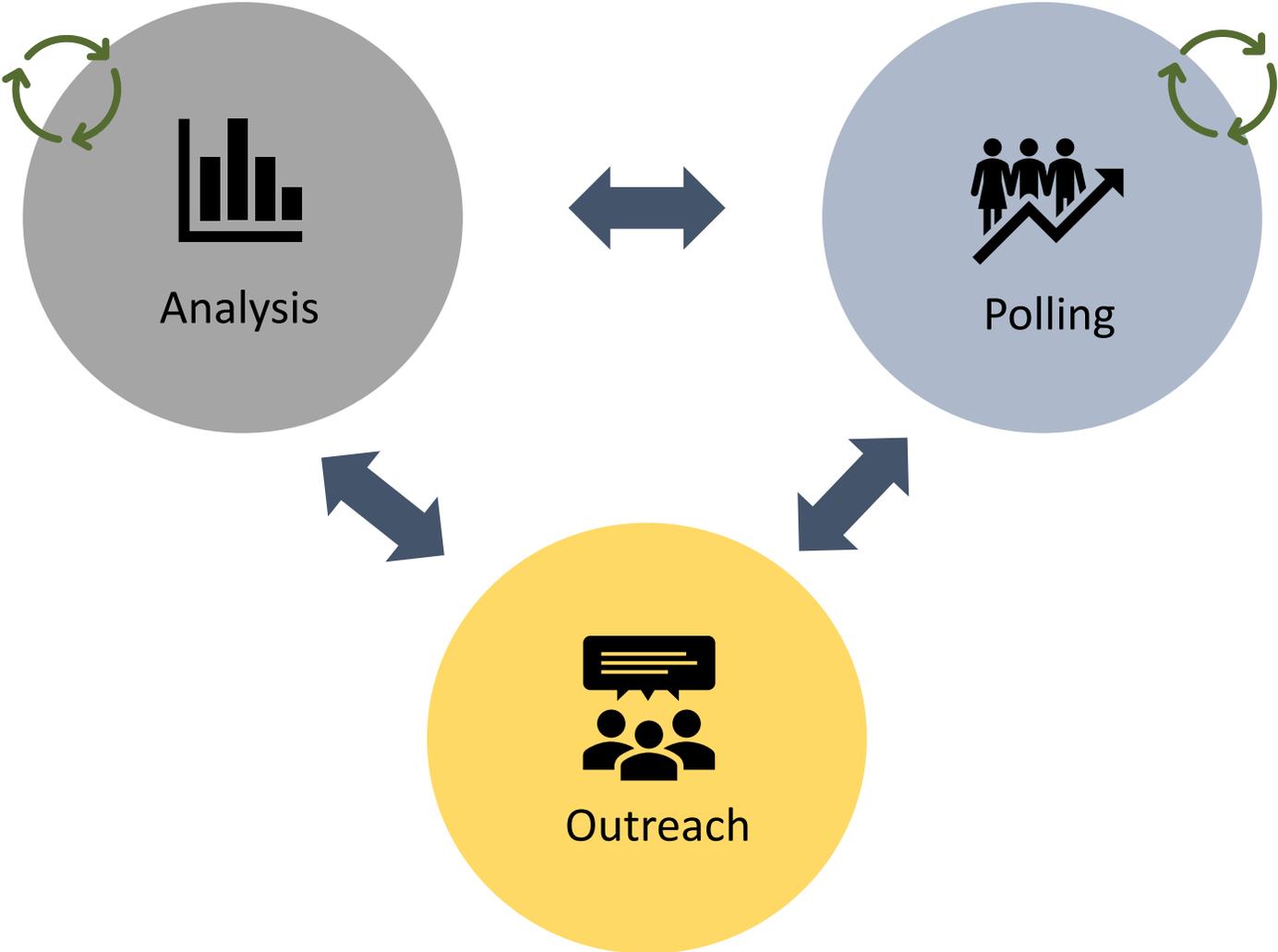
FINANCE COMMITTEE DIRECTION

Recommend that the City Council:

- A. Direct staff to model a business license tax at **monthly rates of \$0.05 to \$0.20 per square foot**, with a preference for **no sunset** and an **annual escalator**, and with **thresholds for square footage size** and possible **exemptions for retail**;
 - A. Discuss and **provide direction on any additional industry exemptions** for further staff analysis;
- B. Model **two methods to replace the General Fund Equity Transfer (GFET)** at risk in the Green case:
 - A. Seek voter approval in **modifying the 2009 GFET formula** to transfer a **percentage of gas utility gross revenues**;
 - B. Distribute the **change across gas and electric** as an increase in the percentage of **Utility Users Tax (UUT)**; and
- C. Incorporate the Finance Committee's **feedback regarding the polling topics** (Attachment A) and to **execute the initial round of polling** and Finance Committee recommends **delegation of review of polls to the Committee**, pending availability to stay on the workplan timeline. Polling should include but not limited to:
 - A. Evaluating support for a business tax and characteristics of it
 - B. Evaluating willingness to support confirmation/replacement of the General Fund Equity Transfer equity gas transfer; and
 - C. Opinion and ranking of funding priorities such as services, infrastructure, and climate action

September 21, 2021 (Passed 3-0) and October 19, 2021 (Passed 3-0)

COMPONENTS OF A POTENTIAL BALLOT MEASURE



WORKPLAN – NEXT 6 MONTHS



June

Finance:

- Recommendation to Council on Workplan; Review and Discuss Affordable Housing

August -

September

Council:

- Direction to staff on ballot measures to pursue and allocation of resources

Finance:

- Accept initial analysis of revenue generating proposals
- Discuss and provide guidance and initial polling and stakeholder outreach

October

Finance:

- Accept refined revenue estimates

November

Council:

- Accept Finance Committee's recommendation of potential revenue-generating proposals, including revised revenue estimates
- Direction to complete initial polling
- Direction to initiate outreach strategy efforts
- Award of Outreach Consultant Contract

December

Finance:

- Accept third round of analysis for revenue generating proposals

Council:

- Consideration of additional refinements and updates and review of initial poll results

WORKPLAN: JANUARY 2022 AND BEYOND



January – April 2022

Finance and Council:

- Decision on revenue-generating ballot measure(s) to pursue
- 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

May – June 2022

Council:

- Final Approval of November 2022 Ballot Measures, including ballot measure language

August 2022

- Language submitted to Santa Clara County Registrar of Voters

November 2022

- Election

December 2022 (and beyond)

- Implementation of any ballot measure that passes

PRIOR WORK ON LOCAL BALLOT MEASURE

The City Council had previously directed pursuit of a local revenue-generating ballot measure through the Fiscal Sustainability Workplan.

- **Equity:** Who does the tax impact and how is that felt across all residents or businesses in the same industry?
- **Aministrability:** How is the tax administered and what would be the cost of compliance on taxpayers and the City?
- **Stability:** What are the drivers of the tax and how does the tax type in question affect the volatility of the revenue over time (including potential recessionary or modernization scenarios)?
- **Economic Benefits:** Is the tax efficient, promote economic development objectives and minimize disruption on the taxpayer?

Structure

- ★ Tax Method(s)/Unit of Measure
- General/Specific & Passage Rate
- Legally Required Exemptions
- ★ Exemptions by Council Policy

Revenue & Modeling

- ★ Taxation Level (% of General Fund, \$ value)
- ★ Rate Structure (flat or tiered)
- Avg. Annual Fee
- Tax Rate per Unit

Administration

- Data Sources
- E.A.S.E.
- Administration/Staffing Levels

POTENTIAL TAX MEASURE PRELIMINARY CALCULATIONS

| TAX OPTION | SQUARE FOOTAGE BASED TAX (Attachment A, CMR 13648) | UTILITY TAX (Attachment B, CMR 13648) |
|---------------------------|---|--|
| Voter Passage Rate | General Tax: simple majority Special Tax/parcel tax: 2/3 supermajority | General Tax: simple majority Special Tax: 2/3 supermajority |
| Rate Structure | Tax rate / sq ft. Modeled total sq. ft in the City & properties with taxable value <i>(Attachment A, Table A4, pkt p. 23)</i> | % of Gas/ Electric Use |
| Annual Revenue | Est. \$10M to \$40M <i>(Attachment A, Table A2, pkt p. 20)</i> | 1% in UUT yields \$0.3M (gas only) or \$2M (gas, electric, water) in revenue |
| Data Source | Third Party Real Estate Databases & City's Property Tax Consultant | Customer Utility Billing Information |
| Administration | Consultant and/or staff overseeing tax administration and contract administration | City's Utility Billing staff |

SQUARE FOOTAGE TAX: PARCEL TAX & BUSINESS TAX

| | <i>Parcel Tax: Non-Residential Properties</i> | <i>Business License Tax: Square Footage Occupied</i> |
|--|--|---|
| Voter Approval Requirement | Requires 2/3 approval, considered to be a special tax | General Tax, simple majority approval Special Tax, 2/3 approval |
| Requirements Regarding Who May be Taxed | <ul style="list-style-type: none"> ▣ Applies to all parcels within a jurisdiction; rates may vary by property type <ul style="list-style-type: none"> ▣ <i>Tiered option for residential</i> ▣ <i>Develop a business support program</i> | <ul style="list-style-type: none"> + Applied to square footage occupied for business activity carried on within the City, regardless of landowner category. <ul style="list-style-type: none"> ▣ Potential leakage (common areas, hallways, etc.) + Broad discretion to define: <ul style="list-style-type: none"> + Entity categories, by type or size + Various rates categories or exemptions |
| Mandatory Exemptions | Ad valorem exemptions for religious, educational, and charitable institutions; hospitals; and non-profits entities, do not apply to locally-adopted parcel taxes | Banks and financial corporations; non-profit entities, including medical and educational institutions, are exempt from this type of local tax |

SQ FT BASED TAX: PRELIMINARY CALCULATIONS

Models reflect a range of rates per square foot:
From \$0.50/SF to \$2.11/SF (annual)

Avg. monthly commercial rent, ~\$6.88/sq. ft.

- Low end (\$10M target): 0.6% increase in rent*
- High end (\$40M target): 2.6% increase in rent*

- Model distinguishes businesses less than 20,000 sq. ft. as “small”
 - Staff seeks Council direction on definition for any small business exemption
- Does not consider any exemptions by law or policy other than size, these reflect simple math for orders of magnitude
- These basic rates will increase as the base of the tax decreases

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 |
| | \$40.M | Annual Fee: \$63,390 Tax Rate: \$2.11/SF | Annual Fee: \$211,300 Tax Rate: \$2.11/SF |

UTILITY TAX

Options to Consider

1. Increase or expand City's UUT rate (rates in orange)
2. Seek voter approval to simplify the General Fund Equity Transfer formula to impose a flat tax on gas utility gross revenues
 - A. Separate percentage of service charges (rates in orange), or
 - B. Affirm current practice (rates in blue)

Table B2: Gas Residential and Commercial Monthly Bill Comparisons

| Type | Usage level (therms) | Palo Alto | PG&E | \$ Diff | % Diff | Palo Alto Excl. Gas GFET | \$ Diff | % Diff |
|-------------|----------------------|-----------|----------|---------|--------|--------------------------|-----------|--------|
| 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% |

Table B1: Modification to City's Utility Rates

| Utility | Estimated UUT Rate | Add'l Revenue for each 1% |
|--|--------------------|---------------------------|
| Gas | 32% | \$284,000 |
| Gas, Electric, Water | 9% | \$1.9M |
| Gas, Electric, Water, Wastewater, Refuse, Storm, Fiber | 7% | \$2.5M |

LEGAL CHALLENGES & EASE

Risk of Legal Challenge

- Utility transfer: cities have been challenged and law remains in flux. Sacramento and Pasadena followed an embedded route. Taxes were approved on appeal.

EASE Framework

- Stability: significant, long-term variables that may impact this revenue source, if applied specifically to gas (i.e. S/CAP) goals to reduce use of natural gas and commodity price fluctuations

POLLING: COUNCIL FEEDBACK REQUESTED

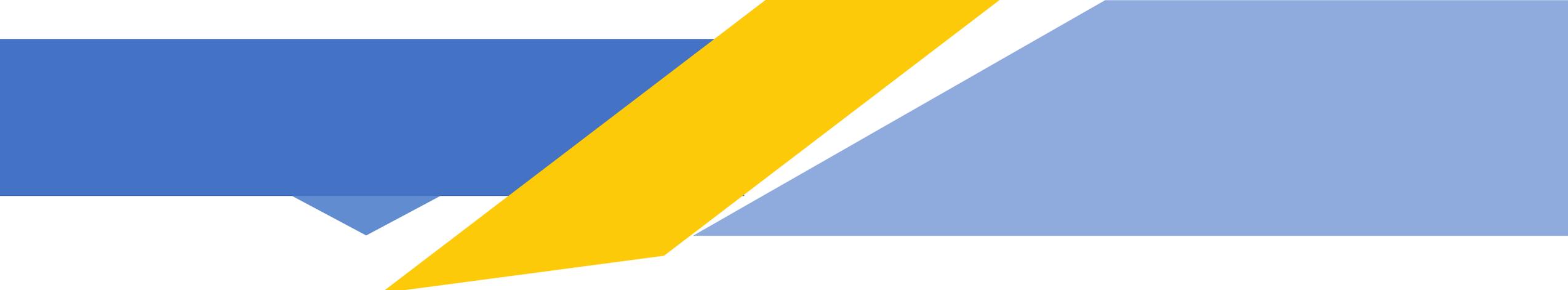
#1: Potential uses of new revenues to poll. Examples:

- Maintaining the City's ability to fund basic City services
- Restore City services cut during the pandemic-related economic downturn, such as library hours, recreational services, and police and fire services
- Investing in community-owned assets like roads, community centers, libraries, parks, and public safety facilities
- Funding affordable housing
- Funding extraordinary community investment needs, such as Caltrain grade separations

#2: Poll only business tax, or both business and parcel tax?

#3: Exemptions to poll for inclusion in business license tax, such as:

- An exemption for businesses under a square footage threshold. The threshold could be unspecified in the first round of polling and become more specific in the second round.
- An exemption for retail
- An exemption for for-profit medical and educational facilities (non-profit facilities are mandated to be exempted by the California Revenue and Tax Code)



Assessing Support for Potential Palo Alto Finance Ballot Measures

Methodology and Outline



OPINION
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& STRATEGY

Research Team



Dave Metz
Partner & President



Miranda Everitt
Vice President

Survey Methodology

| | |
|---------------------------------|---|
| Survey Type | 20-Minute Dual Mode Voter Survey |
| Research Population | Likely November 2022 Voters in Palo Alto |
| Total Interviews | 400 to 800 |
| Margin of Sampling Error | $\pm 4.9\%$ at the 95% Confidence Level for 400 Interviews $\pm 3.5\%$ at the 95% Confidence Level for 800 Interviews |
| Contact Methods |  Telephone Calls  Text Invitations  Email Invitations |
| Data Collection Modes |  Telephone Interviews  Online Interviews |

Survey Objectives



- Update baseline attitudes about City government and issues of concern by re-asking about those topics in the same way we have in prior years
- Assess the design of a potential business tax measure
- Evaluate the impact of "yes" and "no" campaigns
- Briefly, assess opinions of a measure dealing with an equity transfer from the utility fund

Survey Outline: Introduction and Context

- 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)

Survey Outline: 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
- 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

Survey Outline: Assessing the Ballot Measures

- General support for or opposition to a business tax – rotating the order they are heard first
 - Parcel tax
 - Business license tax
- Open-ended question on reason for support/opposition
- General support for or opposition to GFET measure – rotating two approaches
 - Affirming the existing practice of transferring a portion of utility revenues to the City's General Fund to pay for other City services
 - Creating a climate fund to support new and existing City efforts to fight climate change

Survey Outline: Spending Priorities

- Stepping back, here are some reasons the City may place a tax increase on the ballot. Would you support or oppose a City tax increase if it went to...?
 - Maintaining the City's ability to fund basic City services
 - Restoring City services cut during the pandemic-related economic downturn, such as library hours, recreational services, and police and fire services
 - Investing in community-owned assets like roads, community centers, libraries, parks, and public safety facilities
 - Funding affordable housing
 - Funding extraordinary community investment needs, such as Caltrain grade separations

Survey Outline: Spending Priorities, Continued

- 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
 - Services or programs for people who are 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

Measure Components and Pro/Con

- 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
 - Beneath a certain square footage
 - Retail
 - For-profit medical and educational facilities
 - Delegation of creation of exemptions to City Council
 - Sunset or length
 - CPI and escalators
- Arguments in support of a measure, such as fairness, specific uses of the tax revenue, and need for stability in funding, loss of services without new funding, scale of the tax, and comparison to other cities. Then a re-vote.
- Arguments opposing a measure, such as too many taxes, cost of living, potential for mismanagement, and impact on local business during COVID recovery. Final vote.

Demographics

- 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

Deliverables

Following completion of the survey, we will provide the following deliverables:

- A questionnaire with the topline results of the survey for easy reference
- A complete set of crosstabs in an easy-to-read, comprehensive format
- Verbatim responses to any open-ended questions
- A complete analysis of survey results in PowerPoint
- Presentations of the survey results
- Ongoing consultation and analysis

For more information,
contact:



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DRAFT CITY COUNCIL ACTION

The City Council directs the Finance Committee and staff to:

- A. Direct staff to model a business license tax at monthly rates of \$0.05 to \$0.20 per square foot, with a preference for no sunset and an annual escalator, and with thresholds for square footage size and possible exemptions for:
 - i. Retail
 - ii. ...
 - iii. ...
- B. Direct staff to model two methods to replace the General Fund Equity Transfer (GFET) at risk in the Green case:
 - i. Seek voter approval in modifying the 2009 GFET formula to transfer a percentage of gas utility gross revenues;
 - ii. Distribute the change across gas and electric as an increase in the percentage of Utility Users Tax (UUT); and
- C. Direct staff to execute initial round of polling (**Attachment A**), delegate of review of polls to the Finance Committee, pending availability to stay on the workplan timeline, and incorporate Council's feedback of the poll:
 - i. ...
 - ii. ...
 - iii. ...



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