

COUNCIL MEETING

04/18/2022

☒ Received Before Meeting

8

POTENTIAL REVENUE GENERATING LOCAL BALLOT MEASURE

Further Refinement

City Council

April 18, 2022

www.cityofpaloalto.org/fiscalsustainability



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ALTO**

OVERVIEW

Council Direction and Work Plan

www.cityofpaloalto.org/fiscalsustainability

- Staff continues to implement the workplan associated with pursuit of consideration of potential local ballot measures for the November 2022 general election

Updates related to the Finance Committee meeting on 3/28/2022 to discuss tonight:

- Summary and progress report on the Community and Stakeholder Engagement Plan,
- Second poll (Attachments A and B),
- Online and mailed feedback survey (Attachment C),
- Business and community focus groups (Attachment D);
- Components of a ballot measure(s)
 - Business license tax, discussion on ordinance status,
 - Measure to affirm the Gas Funds Transfer draft ballot question and ordinance (Attachment E); and
- Business license tax additional analysis

SUMMARY OF TONIGHT'S DECISION POINTS

- Affirmation of current practice of Gas Utility Transfer
- Confirmation and direction on characteristics of the Business License Tax
- Direction for staff to proceed with a third round of polling
- Direction and input of ballot measure outline to inform full ballot measure text
- Direction regarding optional drafting a potential non-binding resolution to inform the public of Council's intentions regarding use of the Business Tax proceeds

PRIOR COUNCIL DIRECTION & STATUS

The Council moved to direct staff to:

- ★ A. *Pursue preparation of a square footage business license tax with the following characteristics as recommended by the Finance Committee:*
 - i. *Continue to review the rates, adding option 3 (flat fee of \$50 for first 5,000 square feet occupied and apply a monthly tax rate per square foot beyond the 5,000 threshold) as a starting point;*
 - ii. *Exemptions for businesses subject to the Transient Occupancy Tax and grocery stores;*
 - iii. *Annual escalator uses CPI as a basis;*
- ✓ B. *Develop a proposal for voter ratification of the existing gas General Fund Equity Transfer and eliminate the UUT option, with the exploration of whether to cap growth of the transfer to be explored via polling;*
- ✓ C. *Amend the workplan to three polls, with the second poll developed and executed by the City's polling consultant, and the third to test potential ballot language; and*
- ✓ D. *Launch the Community and Stakeholder Engagement Plan, as outlined in the staff report.*

January 24, 2022 (Passed 6-1, Tanaka no)

WORKPLAN: APRIL 2022 AND BEYOND



April 2022

Council

- Discussion of funding resource/spending allocation
- Review Finance Committee work and recommendations
- Review outlines of ordinance language for the business license tax and the measure to affirm the Gas Funds Transfer

Review outline of final poll & direct staff to execute

May 2022

Staff and Consultant Work

- Third and Final round of polling
- Information presentations to local organizations
 - Drafting of full language for ballot question and ordinances
 - Continued Community Engagement through
 - Additional focus groups
- Citywide Newsletter and blog posts

June 2022

Council

- Discussion of funding resource/spending allocation
- Final approval of November 2022 Ballot Measures



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FINANCE COMMITTEE RECAP

Report, Deliberations, & Recommendation

www.cityofpaloalto.org/fiscalsustainability

- **Implementation of the Community and Stakeholder Engagement Plan**
 - Results of the second public opinion poll,
 - Results of the online and mailed feedback survey,
 - Report on the business and community focus groups
- **Additional analysis of components of a potential Business Tax Measure**
 - Calculations to model impacts of the policy exemptions such as hotels and grocery stores,
 - Refined structure of a potential tax including concurrent management of the Business Registry Certificate Program and CPI calculation options
- **Overview of the components of a ballot measure(s)**
 - Draft ballot and ordinance language for affirmation of the Gas Funds Transfer

SUMMARY OF COMMUNITY & STAKEHOLDER ENGAGEMENT

- **Communications channels** deployed:
 - Utility bill insert, a page in the spring Enjoy! Catalog, a citywide mailer, the Uplift Local electronic newsletter
 - Public landing page on the City's webpage to access all information (www.cityofpaloalto.org/fiscalsustainability)
 - City Manager's blog and public comments, and social media outreach
- **Participation:**
 - 394 survey responses
 - 5 focus groups with 27 participants + a listening session
- **Feedback:**
 - Gas transfer had support or was neutral due to lack of familiarity
 - Business License Tax had either conditional or no support
 - Concerns: no cap on the CPI, no sunset, not the right time, need a funding plan



FINANCE COMMITTEE MOTION TO THE CITY COUNCIL 03.28.22

Council Member DuBois moved, seconded by Vice Mayor Kou for the Finance Committee to recommend that the City Council consider:

- A. Gas ballot language to include 18% and current uses
- B. Business tax ballot language to include
 - i. Exempt hotels
 - ii. Exempt groceries, require amount of use for food sales
 - iii. Exempt seasonal businesses less than 90 days
 - iv. Require BRC and exempt first 5000 sq ft
 - v. Proposed escalating rate over 3 years starting in 2024 at \$0.12 a sq ft per month, at \$0.15, \$0.20 then CPI capped at 6% per annum with excess CPI carrying over to future years
- C. Recommend the City Council direct staff to proceed with a third round of polling based on Finance Committee and Council's feedback

MOTION PASSED: 3-0



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Updating Palo Alto Voter Views of Potential Ballot Measures

*Key Findings of a Survey of Palo Alto Voters Conducted March 8-14,
2022*



OPINION
RESEARCH
& STRATEGY

Survey Methodology

Dates	March 8-14, 2022
Survey Type	Dual-mode Voter Survey
Research Population	Likely November 2022 Voters in Palo Alto
Total Interviews	427
Margin of Sampling Error	(Full Sample) $\pm 4.9\%$ at the 95% Confidence Level (Half Sample) $\pm 6.9\%$ at the 95% Confidence Level
Contact Methods	 Telephone Calls  Email Invitations  Text Invitations
Data Collection Modes	 Telephone Interviews  Online Interviews

(Note: Not All Results Will Sum to 100% Due to Rounding)



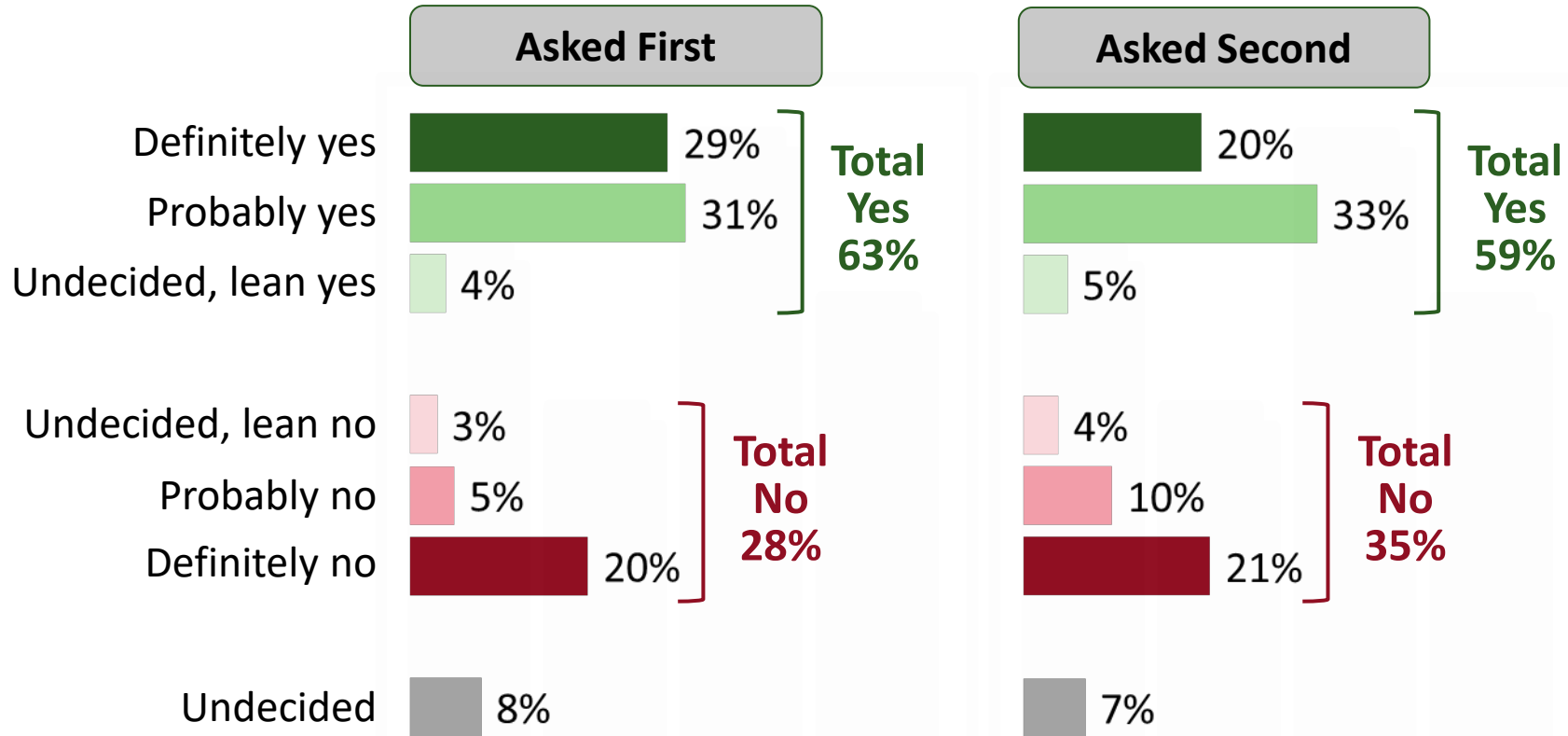
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Voter Views of Ballot Measure Concepts

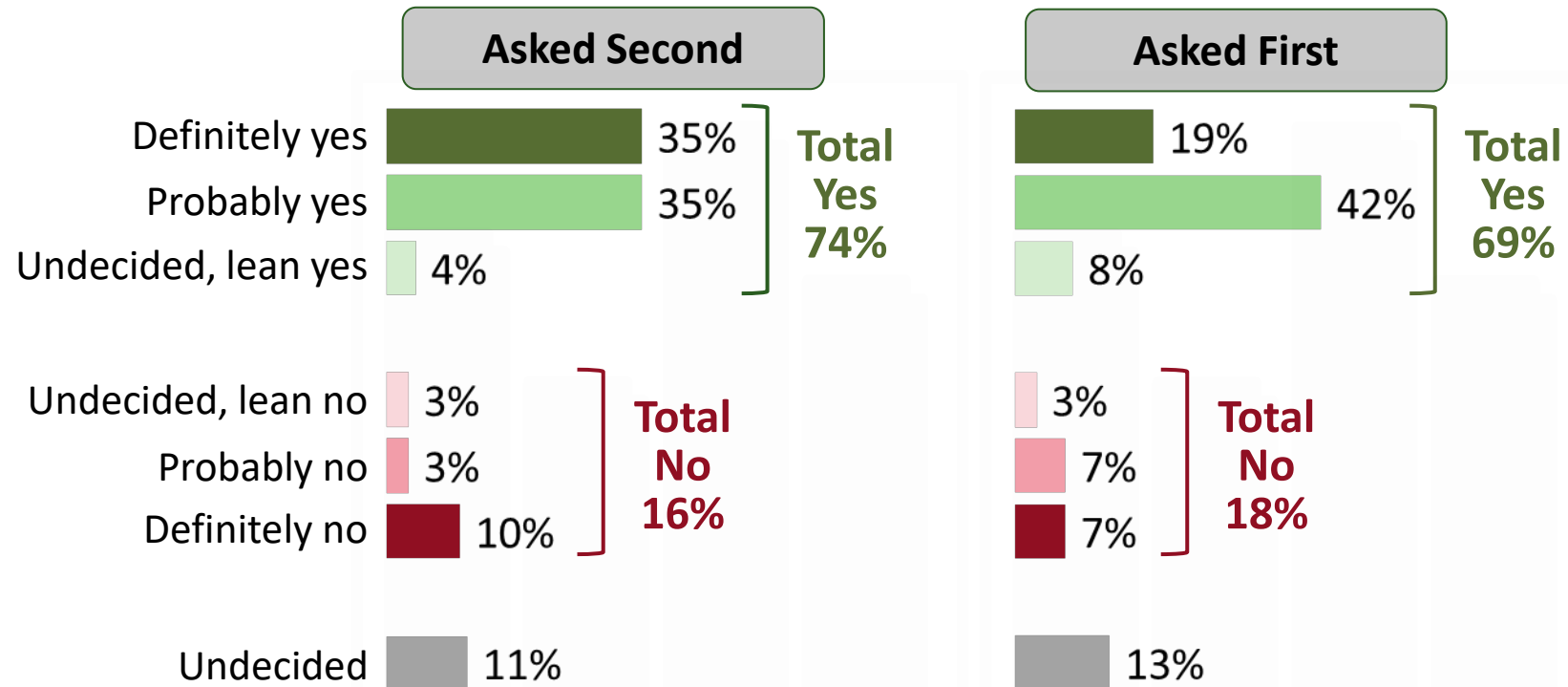
About three in five support a business license tax conceptually.

The measure would deal with a business license tax. This measure would create a business license tax on commercial property in the city of \$50 per year for the first 5,000 square feet occupied, plus 12 cents per square foot per month for space occupied over 5,000 square feet, adjusted annually for inflation. The funds would pay for City services such as police, fire and emergency medical services, affordable housing and support for the unhoused, parks and recreation, transportation, the City's climate action plan, and other public services.



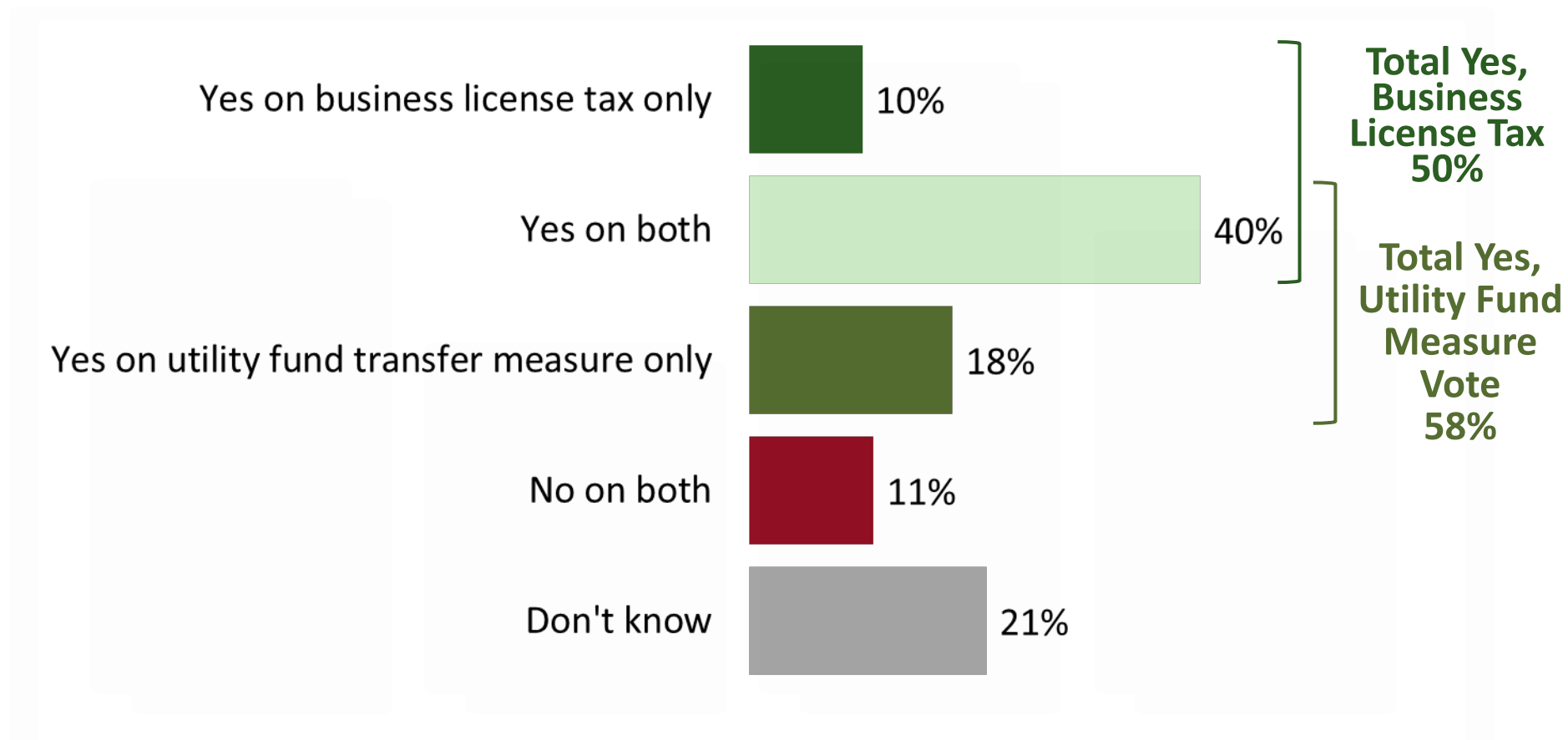
The utility fund measure has support from at least seven in ten voters.

The **FIRST/SECOND** measure would deal with utilities. As you may know, the City of Palo Alto provides natural gas service to residents and businesses. As part of its routine budget practices, the city annually transfers some money from the utility fund to the general City budget which maintains core services. This measure would confirm the existing practice of transferring not more than 18% of City of Palo Alto Utilities' gross annual sales of gas, providing over \$7 million annually to needed investments like police, fire and emergency medical services; affordable housing and support for the unhoused; parks and recreation; transportation; the City's climate action plan; and other public services. This measure would not increase utility rates.



In a head-to-head test, two in five said they would vote “yes” on both measures.

If both of these measures were on the same ballot, would you vote “yes” on both, for just one, or for neither?





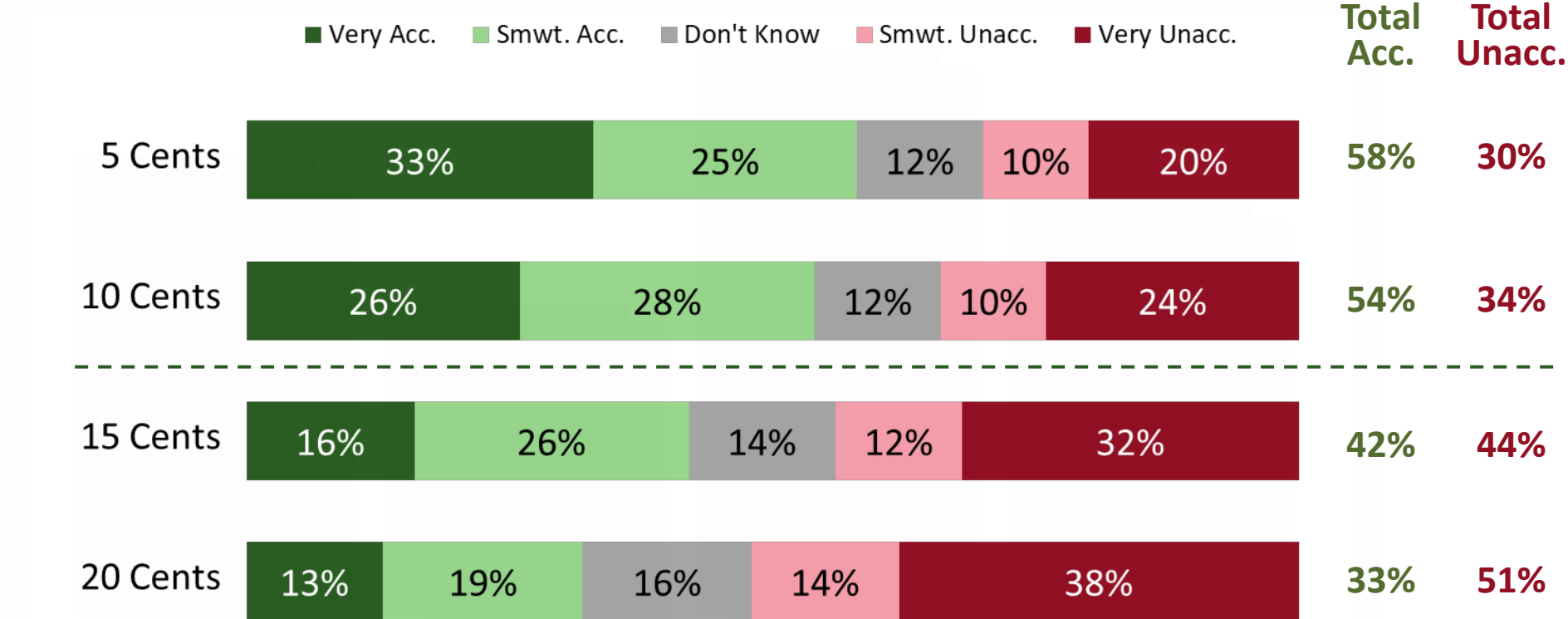
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Structuring a Business License Tax

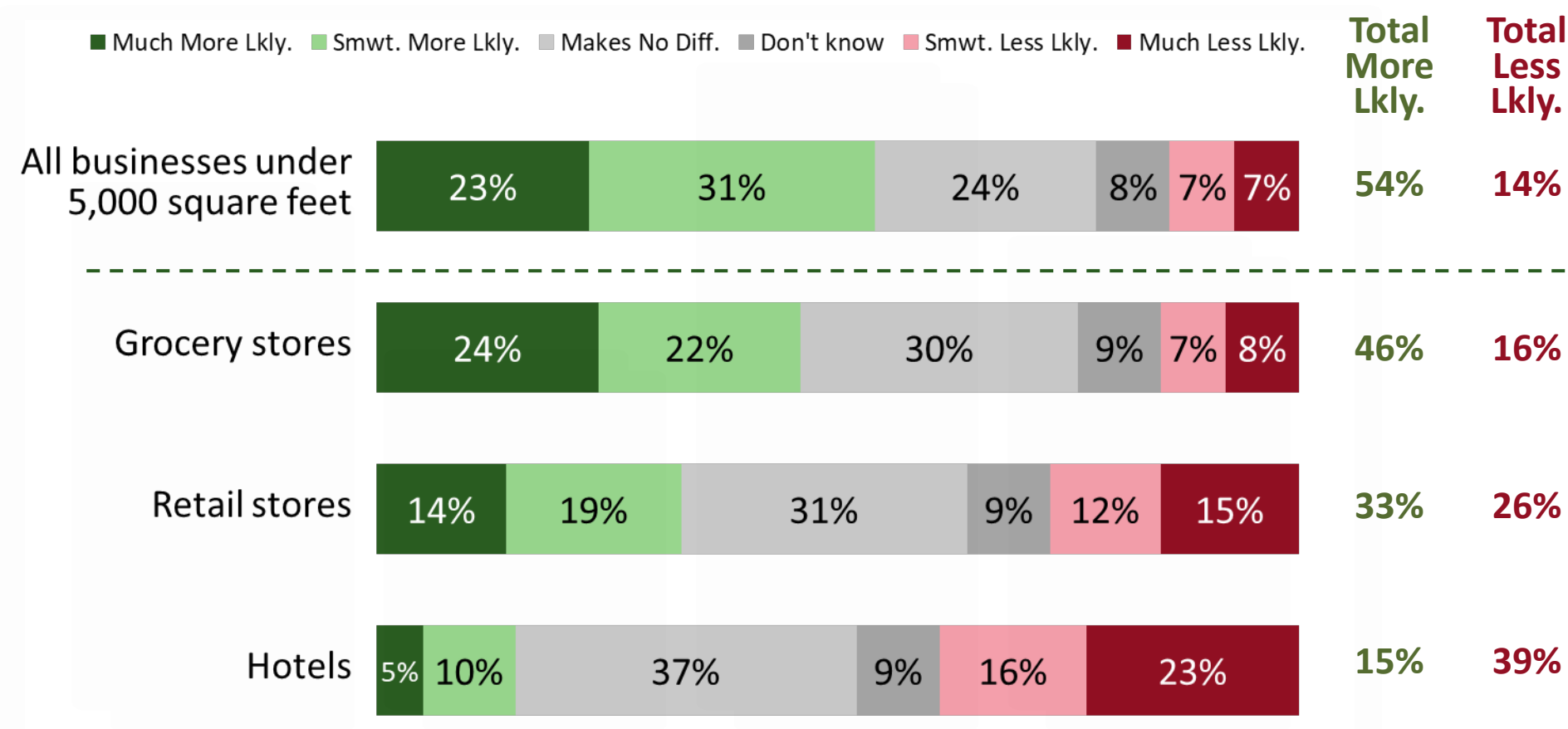
Majorities are comfortable with a rate that would increase rent by 10 cents per square foot.

The structure of this measure has not been finalized. Currently, average monthly rents for businesses range from \$4.10 to \$6.40 per square foot per month for retail and industrial space and \$7.10 to \$8.50 per square foot per month for office space. Would a measure that increased monthly business rent by roughly ___ per square foot be an acceptable or unacceptable amount?

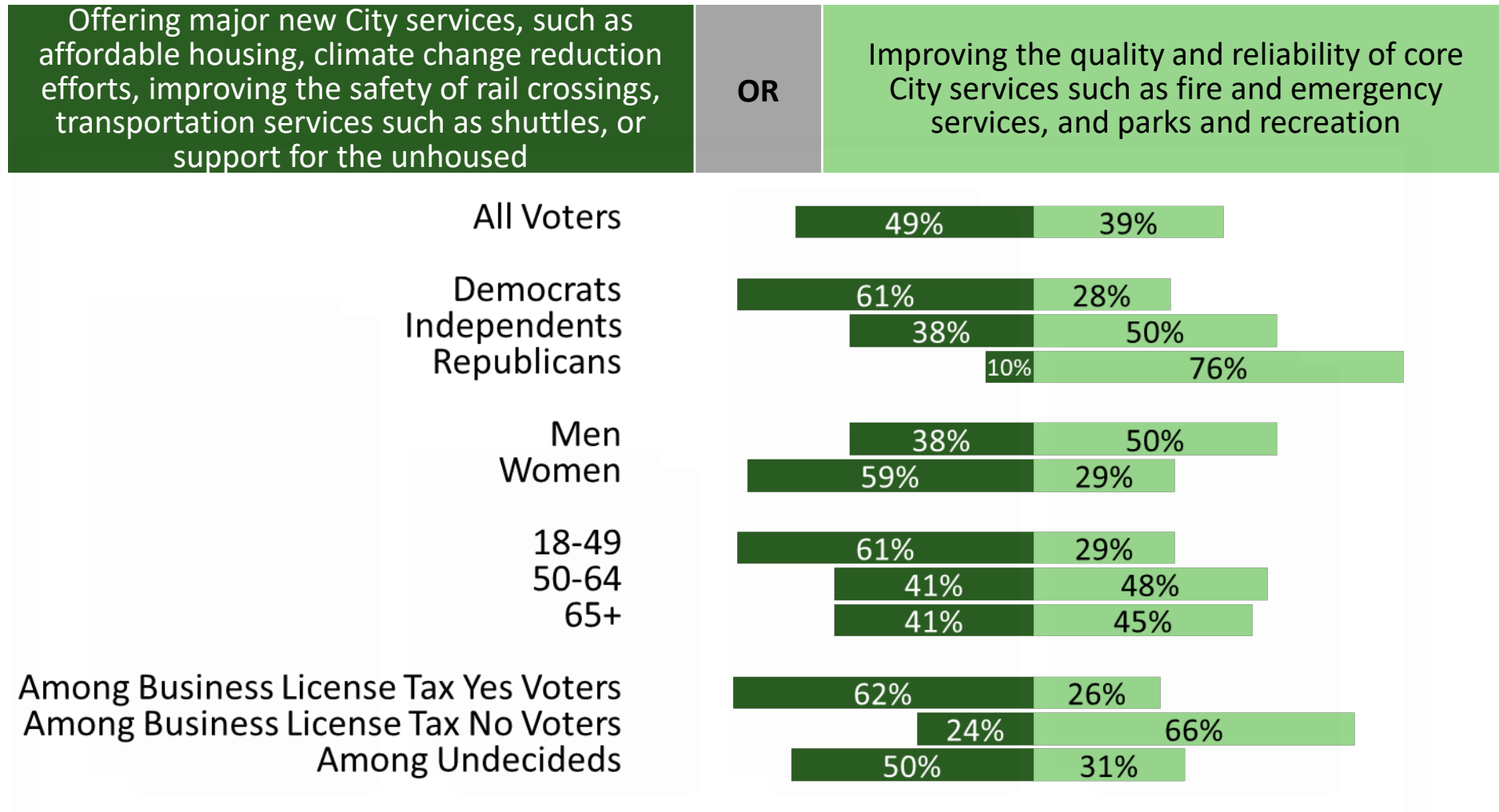


Exemptions for small-square-footage businesses are a plus; an exemption for hotels is more of a minus.

If it were written to exempt _____ from the tax, would you be more likely to support it or less likely to support it? If it makes no difference, you can tell me that instead.

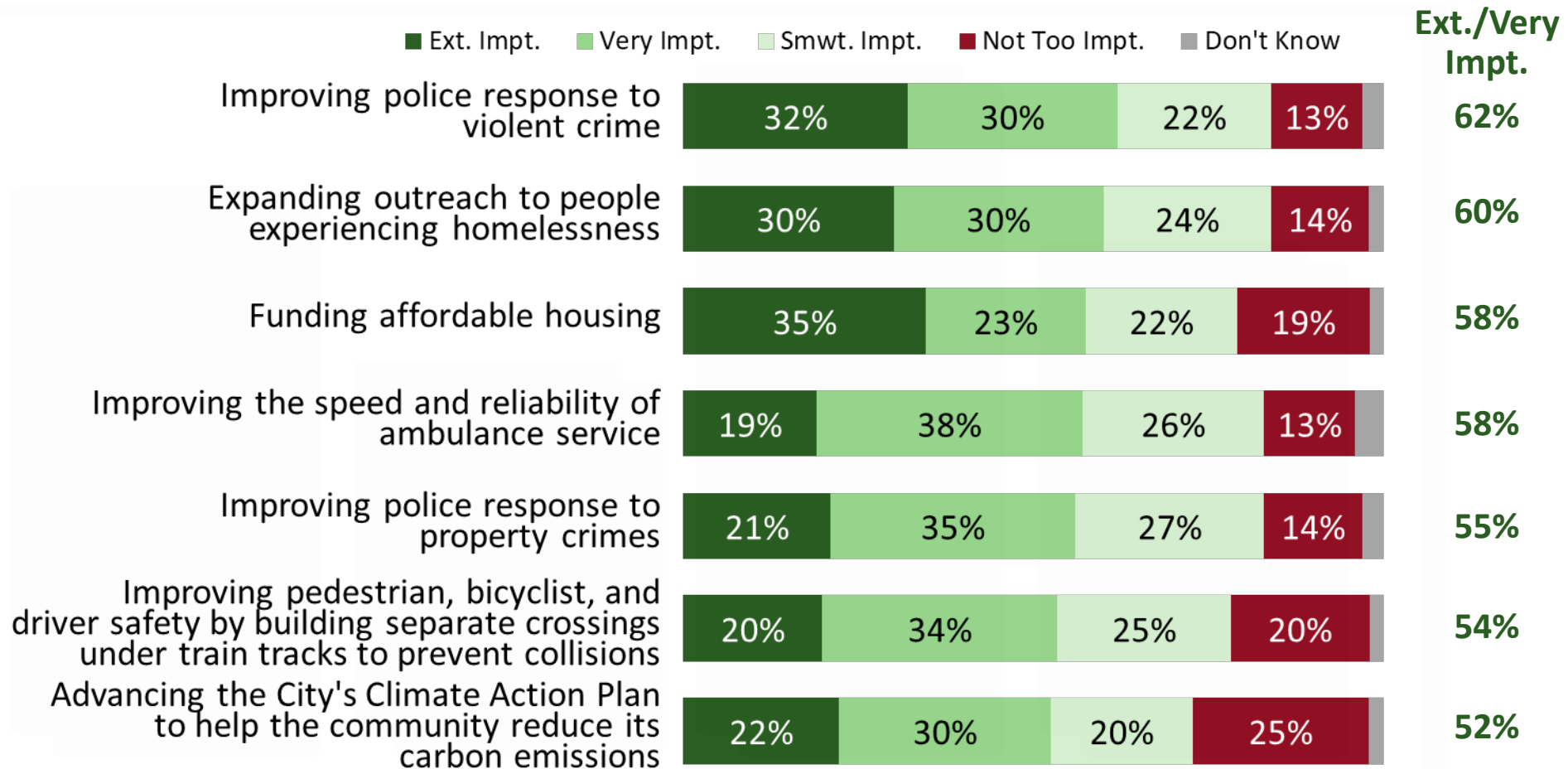


Voters are split on their desired focus for new revenue, with a strong preference for major new investments among Democrats.

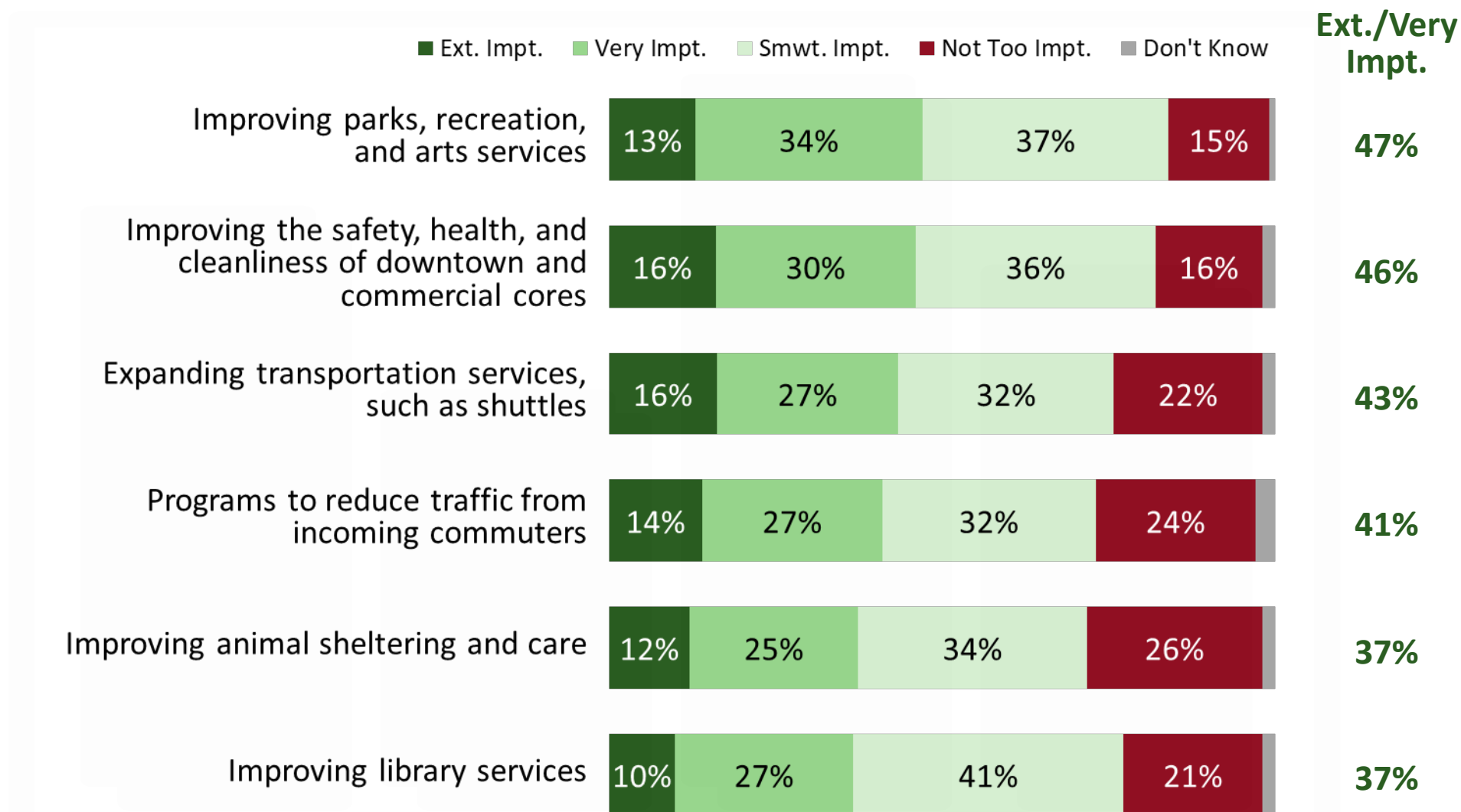


Improvements to public safety, homelessness and housing services are seen as most important.

I am going to read you a list of more-specific ways in which funds generated by a tax could be spent. Please tell me how important each item is to you personally: extremely important, very important, somewhat important, or not too important.



Voters value library services, animal sheltering, and transportation with less intensity.



Support Messages Tested

(Ranked in Order of Effectiveness)

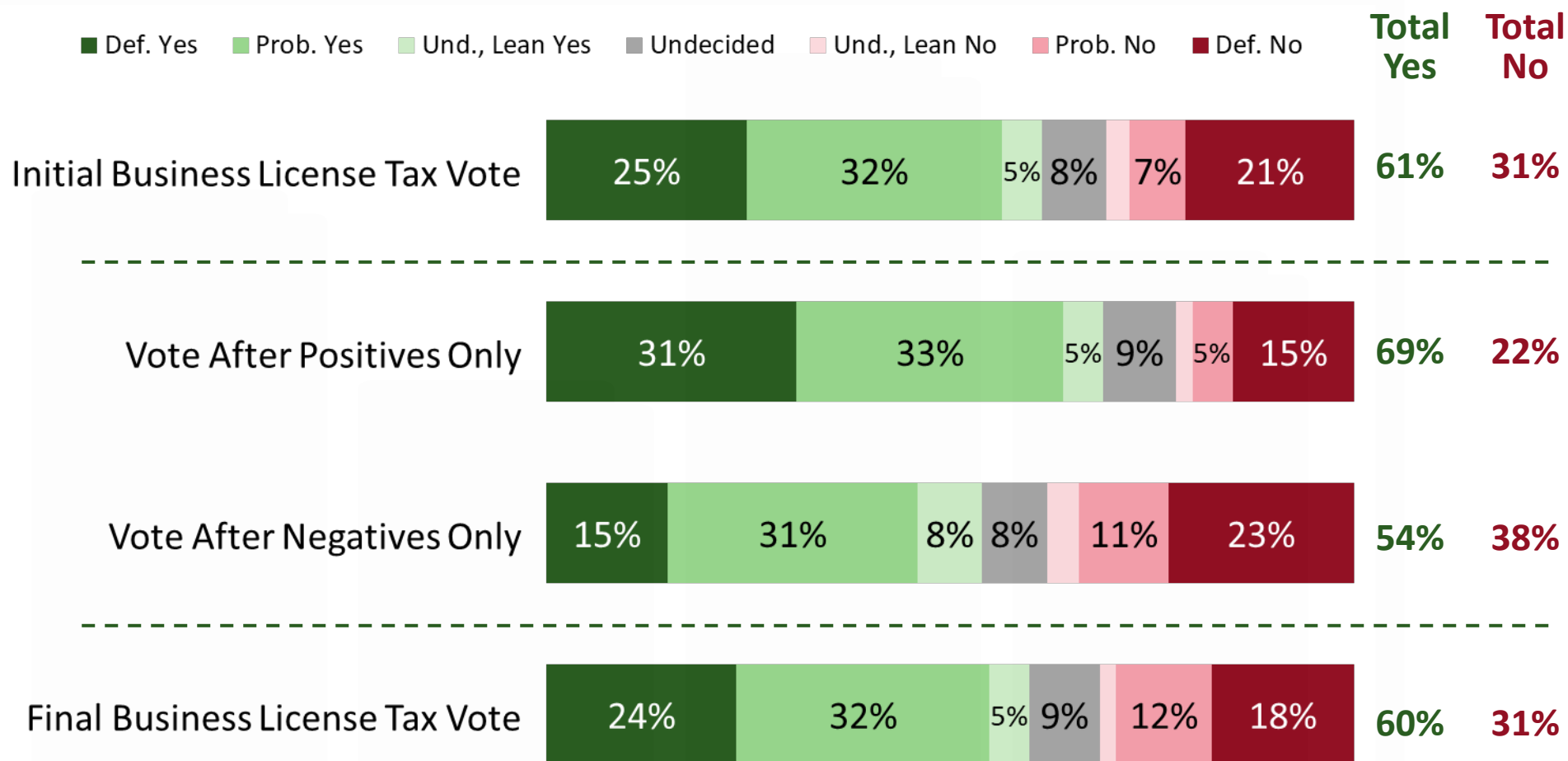
46%	(FAIR SHARE) Palo Alto currently registers businesses of all sizes for \$50. That means a mom-and-pop coffee shop pays the same as a tech company with thousands of employees. This measure is a sensible way to ensure large businesses pay their fair share for the services the City provides and that their employees enjoy, like road repairs and police and fire protection.
31%	(COMPARISON) Palo Alto does not have a business license tax, unlike most communities in California. Several nearby communities have significant taxes on business, such as East Palo Alto's tax of \$2.50 per square foot annually on commercial office space over 25,000 square feet and San Francisco's business tax of \$2.85 to \$5.60 per \$1,000 of gross receipts annually. This tax would align Palo Alto's tax system with those of other cities in the area.
30%	(TAX BASE) This measure is not a tax on homeowners or shoppers, but on the city's largest businesses. Sales taxes continue to decline in Palo Alto, and by diversifying the City's tax base with a thoughtfully designed business license tax, we will be better able to weather future financial crises without having to raise taxes on everyday residents.
27%	(ACCOUNTABILITY) This measure will be subject to strict accountability provisions like annual financial audits; full public disclosure of all spending; and a requirement that all funds be spent locally in Palo Alto. This will ensure funds are used efficiently, effectively, and as promised.
23%	(SAFETY) The recent economic downturn had significant impacts to funding for police and emergency services. Recently the community has seen increases in property crimes impacts to fire and emergency medical services. This measure would provide funding for police and emergency services to address these issues.

Opposition Messages Tested

(Ranked in Order of Effectiveness)

34%	(LOOPHOLES) Just like any tax, this will fall hardest on small and medium businesses already struggling with labor shortages, inflation, and high commercial rent. Meanwhile, the largest companies will find creative loopholes to get out of paying their fair share.
33%	(INFLATION) The cost of living is out of control and inflation is on the rise. With the price of groceries and gasoline increasing and an interest-rate hike on the way, now is simply not the time to be raising taxes.
32%	(RECOVERY) COVID-19 restrictions have already pushed many local businesses to slash hours or even close. The last thing we need to do is drive up prices with a tax that hurts local businesses just as we start to recover.
31%	(WASTE) Given the amount of money we already pay in city, county, and state taxes, and the amount we pay for expensive employee pensions, salaries, and healthcare benefits, City government simply needs to tighten its belt, work together, and do a better job with the dollars they already have.

A majority supports the measure throughout exposure to pro and con messages.





Conclusions

Conclusions

- The mood of the city continues to be mixed, as it is in many cities around region. A slim majority rates City government's performance as "excellent" or "good" (51%).
- Three in five back the business license tax concept we tested, which – pending a more detailed exploration of a more specific concept and associated ballot language – has consistent majority support.
- Voters are comfortable with a measure that would increase average monthly rent for businesses by up to 10 cents per square foot. They are more likely to support a measure that exempts small-square footage businesses, and are less likely to support one that exempts hotels.
- A measure ratifying utility fund transfers polls at 71%; support remains high when voters hear a more detailed explanation.
- Voters are divided on whether they would prefer new revenue be dedicated to major new investments or to improving existing services – however, those who support the BLT are more likely to favor new investments.
- Voters are most enthusiastic about allocating funding toward public safety, affordable housing, and outreach to the unhoused.

For more information, contact:



OPINION
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POTENTIAL BALLOT MEASURE STRUCTURES

Outline for Adjustment & Direction

COMPONENTS OF A BALLOT MEASURE

For each local measure, the official ballot includes:

- Letter designation generated by the County Registrar of Voters;
- Ballot question (a clear, accurate statement that describes what the measure will do, not to exceed 75 words); and
- Space for voters to mark their vote for or against.

In advance of the election, registered voters receive a Voter Information Guide that includes:

- Impartial analysis of the measure prepared by the City Attorney;
- Full text of the measure; and
- Arguments for and against.

OUTLINE OF BUSINESS TAX STRUCTURE

Gross Proceeds Est.
\$43M/Yr (year 3)
[Est. ~\$22M year 1]

Purpose	Allocated to the General Fund for general government purposes
Disposition of Revenue	<div>The following would be exempt from payment of the tax<ul style="list-style-type: none">Any organization exempt under federal or California state lawsGrocery or Supermarket stores that are identified as “full-service markets”Any hotel operator as defined in PAMC 2.33First 5,000 square feet of all businessesSeasonal businesses operating less than 90 days</div>
Calculation	Measured by square feet
Rate	<div><ul style="list-style-type: none">\$0.20/sq ft/mo(\$2.40/sq ft per yr)Three-year phase in of the tax with the following rates (estimated to begin 01/2024)<ul style="list-style-type: none"><u>Year 1</u>: \$0.12/sq ft /mo (\$1.44/sq ft per yr); <u>Year 2</u>: \$0.15/sq ft /mo (\$1.80/sq ft per yr); <u>Year 3 and beyond</u>: \$0.20/sq ft/mo(\$2.40/sq ft per yr)<u>Year 4</u>: Annual increase based on Bay Area CPI, with a 6% cap per annum and any excess CPI above 6% carrying over to future yearsPenalties and interest to be assessed for non-compliance</div>
Council Authority	<div><ul style="list-style-type: none">Designate authority for the City Council to adjust rates or other provisions in any manner that does not increase the tax.</div>
Audit	Provision of audit authority



MEASURE TO AFFIRM GAS FUNDS TRANSFER

**Ongoing Proceeds
Approx. \$7M
annually**
(based on current
contributions)

Table 2: Summary of Gas Utility Transfer Affirmation

Purpose of Measure	Voters to affirm the City's past practice of annually transferring from the gas utility an amount up to 18% of gas utility gross revenues to the general fund for general government use.
Disposition of Revenue	Proceeds allocated to the General Fund for general government purposes of the City ('general tax' requires majority voter support)
Method of Calculation	<ul style="list-style-type: none"> • Tax would be measured by gross revenues of the gas utility received during the fiscal year two fiscal years before the fiscal year of the transfer • The projected cost of the transfer would be included in the City's retail gas rates as part of the cost of providing gas service.
Rate	<ul style="list-style-type: none"> • An amount equal to 18% of the gross revenues of the gas utility. This measure would confirm the City's past and current practice and would not increase utility rates from current levels.
Council Authority	<ul style="list-style-type: none"> • City Council may decide to transfer a lesser amount from voter approved levels



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COUNCIL FUNDING ALLOCATION

Non-Binding Intentions for Use of Tax Proceeds

REVENUE GENERATING BALLOT MEASURES

- By law, the proceeds would be placed in the City's general fund to be spent on general government purposes
- City Council priority in 2019 of Fiscal Sustainability to maintain the quality-of-life
 - Priorities of railroad/grade separation and affordable housing identified as needs
- Unanticipated impacts further impacted fiscal sustainability:
 - Impact of COVID-19 pandemic resulted in a \$40 million gap between revenues and expenses and resulted in significant reductions in services and concessions
 - Local court decision in 2021 that a portion of the City's longstanding annual transfer from the Gas utility could not lawfully continue
- Reductions expected to persist without additional revenues; long-range financial forecast reflecting deficits until FY2030

AFFIRMATION OF GAS TRANSFER & ALLOCATION OF FUNDS

- Palo Alto gas ratepayers have funded contributions to the City's general fund as adopted by voters in the 1950's
 - Services supported by this include police protection, fire and emergency medical services, local parks, community centers and libraries,
 - Majority of municipal utilities in CA make similar transfers to help fund government services as investor-owned utilities collect funds paid to investors as profit
- While the court ruling in FY 2021 is not final and has been appealed, City leaders believe it is prudent to seek voter affirmation on its longstanding past practices
- FY 2023 Proposed Budget, staff expect allocation of one-time funds to the temporary restoration of services.

Reinvestments and allocation of these funds if approved by voters include: police officers, fire services, support for the City's community centers, children's theater productions, library hours, and support for the City's current and long-range planning efforts.

POTENTIAL BUSINESS TAX ALLOCATION OF FUNDS

- **New/enhanced services:**
such as but not limited to special police teams to support traffic and downtown core safety, robust economic development, additional emergency medical services such as supporting new service delivery models for supporting mental health crisis
- **Investment in transportation:**
improving pedestrian, bicyclist, and driver safety and mobility by building separate crossings under train tracks to prevent collisions and improve circulation
- **Investment in affordable housing and services for unhoused:**
supporting community members experiencing homelessness including resources for housing programs as well as renter protection support projects
- **Investment in unfunded Capital Improvements:**
investing in projects such as the parks master plan, Palo Alto animal shelter, Cubberley Community Center rehabilitation
- **Investment in the Council's sustainability and climate action:**
investing in protection and adaptation plans reducing carbon emissions

SCENARIOS OF BUSINESS TAX PROCEEDS ALLOCATIONS

Table 3: Scenarios Illustrating Potential Uses of Business License Tax Proceeds

	Tax Rate: \$0.10/SF Estimated Gross Revenue: \$21M annually	Tax Rate: \$0.20/SF Estimated Gross Revenue: \$43M annually
<i>New/Enhanced Services</i>	\$4M	\$8M
<i>Railroad/Train Crossing Safety</i>	\$7.7M (~\$100M in financed proceeds ¹)	\$15.4M (~\$100M in financed proceeds ⁴)
<i>Affordable Housing/ Unhoused Services</i>	\$5M financeable &/or pay go	\$10M financeable &/or pay go
<i>Unfunded Capital Improvements</i>	\$2M financeable &/or pay go	\$6.6M financeable &/or pay go
<i>Sustainability & Climate Action: Protection & Adaptation</i>	\$1M	\$2M
<i>Administrative Expenses</i>	\$0.5M-\$1M	\$0.5M-\$1M

These scenarios are not binding. By law, the proceeds of this potential measure will be placed in the City's general fund, where they can be spent on any general government purposes. That decision will be made each year by the sitting Council.

Staff have used a broad ratio to illustrate the approximate capacity to finance proceeds. This illustration assumes that every \$1 in revenues can lead to financed proceeds of \$13-\$14 assuming a 30-year debt service. This ratio is extremely uncertain and will vary due to economic factors, status of the market, and structure of the debt. It should be used for understanding orders of magnitude for future planning only.



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CONCLUSION, TIMELINE, POLLING

Planned Next Steps & Council Direction

IMMEDIATE NEXT STEPS

With the City Council's direction as part of this item, staff will move to a more refined stage of this workplan with the goal for the Council to consider placement of a ballot measure(s) for voters' consideration at the last Council meeting in June 2022

Immediate work in April/May 2022:

- A third round of polling based on the outline in Attachment A
- Drafting of full ballot measure text (ordinances) in accordance with tables 1 and 2
- Stakeholder Engagement focus groups on structure and administration of draft measure(s)
- FY 2023 annual budget process

Staff plan to return to Council at it's first meeting in June to report out on this work for final decisions and direction before placement of a measure(s)

Structure

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

Revenue & Modeling

- ★ Taxation Level
- ★ Rate Structure (flat or tiered)
- ★ Avg. Annual Fee
- ★ Tax Rate per Unit

Administration

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



1. Affirmation of current Gas Utility Transfer at 18% of the gas utility's gross receipts
2. A Business License Tax with the following characteristics:
 - a. Tax is determined based on a business's occupied square footage in Palo Alto
 - b. Exemption for hotels (that collect/remit Transient Occupancy Tax)
 - c. Exemption for groceries (requires a given % of sq ft. of food sales to qualify)
 - d. Exemption for seasonal businesses operating less than 90 days
 - e. Exemption for first 5,000 sq ft
 - f. Tax rate of \$0.20/sq ft per month
 - g. Tax to be due beginning January 1, 2024
 - h. Three-year phase-in provision: reduced monthly rate of \$0.12/sq ft for 2024; rate of \$0.15/sq ft for 2025; and full rate of \$0.20/sq ft beginning in 2026
 - i. Beginning in 2027, tax rate to increase by the CPI, capped at 6% per annum
 - j. Confirm that the City's Business Registry program will continue to operate and be required for all businesses except as exempted by the BRC ordinance.
3. Recommend the City Council direct staff to proceed with:
 - a. A third round of polling based on the attached outline (Attachment A)
 - b. Drafting of ballot question and full ballot measure text (ordinances) in accordance with tables 1 and 2 in this report for a potential Business License Tax and Affirmation of current Gas Utility Transfer.



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