



City of Palo Alto

Infrastructure Committee Staff Report

(ID # 4816)

Report Type: Action Items

Meeting Date: 5/20/2014

Summary Title: Revised Draft Infrastructure Project Funding Proposal

Title: Review and Recommendation to Council to Approve the Revised Draft Infrastructure Project Funding Proposal, Discussion of Draft Transient Occupancy Tax Ballot Language, and Direction on Polling

From: City Manager

Lead Department: City Manager

Recommendation

Staff recommends that the Committee review and make a recommendation to Council to approve the revised draft infrastructure project funding proposal, approve the draft transient occupancy tax ballot language, and provide direction on whether additional polling should occur.

Background

At the March 3, 2013 Palo Alto City Council meeting Council reviewed a draft infrastructure project funding proposal that had been recommended by the Infrastructure Committee for Council review (Attachment A). Additionally, at the March 3, 2014 Council meeting Council considered the Infrastructure Committee's recommendation to move forward with a three percentage point Transient Occupancy Tax (TOT) increase. Following Council discussion at the March 3, 2014 meeting, Council approved a reduction in the proposed TOT increase from three percentage points to two percentage points. Due to this reduction in the proposed TOT increase, Council referred the draft infrastructure project funding proposal to the Infrastructure Committee to consider changes to the \$132.2 million project list in light of this reduction in the proposed funding.

Revised Draft Infrastructure Project Funding Proposal

Since a one percentage point increase in the TOT rate is expected to raise \$1.1 million per year which, via debt financing in the form of Certificates of Participation (COP's), can support \$15.4 million worth of infrastructure expenditures, the \$132.2 million expenditure plan had to be reduced by \$15.4 million to \$116.8 million.

To close the \$15.4 million gap, staff recommends the following projects be reduced or postponed from the \$132.2 million plan:

Projects Proposed for Postponement	Reduction (in millions)
Bike/Pedestrian Master Plan	\$1
Parks Catch-Up	\$4.6
Byxbee Park	\$0.8
Fire Station 4	\$7.5
Total	\$13.9

This \$13.9 million reduction is less than \$15.4 million because staff was able to identify an additional \$1.5 million in funding to help offset the TOT reduction. Therefore, there are adequate resources to fund \$118.3 million worth of projects (\$132.2 million - \$13.9 million = \$118.3 million)

Reconciliation between the funding proposal presented on March 3, 2013 **and staff's** revised recommendations are attached (Attachment B). This attachment displays the \$132.2 million in projects recommended by the Infrastructure Committee to Council on March 3, the project reductions recommended by staff to close the funding gap created by the reduced TOT increase, and the funding sources required for the \$118.3 million in infrastructure work.

To reconcile the delta between project costs and revenue sources, staff used its best judgment for where proposed project reductions should occur. A high level overview of **staff's justifications** for the proposed project reductions are below:

- There will likely be future grant opportunities to fund the Bike/Pedestrian Plan lowering the need for City funding
- Similar to other projects previously removed from the draft infrastructure project funding proposal by the Infrastructure Committee, Parks Catch-Up work and part of proposed Byxbee Park work can be either delayed or **funded within the City's** Capital Plan, revenue permitting
- While in need of modernization, especially seismic improvements, Fire Station 4 remains functional and continues to provide fire suppression services in the absence of a major natural disaster. A full reconstruction of Fire Station 3 is still included in the plan.

To demonstrate that adequate resources are available for \$118.3 million in infrastructure work please see Attachment C. This attachment shows the uses and sources for the proposed projects. **In the "Sources" section of the attachment**, one-time funds are shown to total \$53.77 million. These consist of the same sources the Infrastructure Committee has been discussing, such as Stanford Development

Agreement funds and Infrastructure Reserve monies. The use of these funds is shown by year.

The remaining funding of \$64.5 million will be financed **using COP's**. The revenue streams necessary to support this annual debt service will be derived from new hotels in Palo Alto and the two percentage point TOT increase.

Again, together with available one-time funds, all of the infrastructure projects outlined in this plan can be achieved. In addition, revenues in excess of debt service in fiscal years 2016 and 2017 can be used for other projects, or to reduce out-year borrowing, on a cash flow basis.

Not included in the analysis above is that when a new Public Safety Building (PSB) is built a new revenue stream will be generated by renting the old Police wing located at City Hall. This rental revenue stream will be used to support annual debt service on the new PSB building. Once completed and occupied, the old Police wing is conservatively estimated to yield \$1.4 million annually.

There are a multitude of variables that can and will impact expenditures and revenue streams. Examples are, but not limited to, future construction costs, land costs, the sensitivity of TOT revenue streams to economic cycles, interest rate movements, the **City's credit rating as its borrowing increases, and the bond market's view of municipal debt**.

Another component to consider is that the resource plan discussed here does not account for other, potential significant General Fund expenditures and loans the City is considering or for which it is committed. For example, it does not incorporate a potential purchase of the downtown Post Office (PO). Although the PO will generate a rental stream justifying its purchase and eventually offsetting expected debt, the purchase will affect the near term cash flow outline presented in this report and the debt level the City will bear. Likewise, with anticipated construction of a new Golf Course, it is **staff's intent to** be able to optimally balance the use of available cash to minimize capitalized interest costs as well as to cover costs by potentially advancing some funds until the Joint Powers Authority (JPA) remits its mitigation payment. This too could affect the cash flow picture.

Eventually, \$6.1 million of debt (excluding issuance costs and capitalized interest) will be issued to cover part of Golf Course capital costs and Golf Course revenues are expected, after ramping up rounds, to cover this debt as well as operating expenses. Finally, up-front cash will be needed to make improvements to the Airport. Eventually, 90% of the capital expenditures will be reimbursed by the federal government, but this will create a draw on cash resources.

When needs outside of the infrastructure project funding proposal are incorporated in the funding proposal, the cash flow picture becomes more complicated and dependent on the timing of projects and revenue streams. As the infrastructure project funding proposal and other projects unfold in the future, Council will see a variety of temporary **“transfers”** and/or **“loans”** via **Budget Amendment Ordinances (BAO’s)** to fund projects and minimize borrowing costs.

In conclusion, at this point in time, there are adequate resources to move forward with the projects identified in the revised draft infrastructure project funding proposal. The proposal, plus other capital acquisitions and projects, will require careful year-to-year cash flow monitoring with the objectives of minimizing debt obligations and additional expenditures.

Proposed TOT Increase Ballot Language

Below is draft ballot language the City Attorney’s Office has prepared for review:

- **“To provide funding that cannot be taken away by the State for general fund infrastructure and City services such as earthquake safe fire stations; pedestrian and bike improvements including safe routes to school, streets, sidewalks, paths, and bridges; and maintaining parks and recreation facilities, shall the City increase the hotel/motel tax by two percentage points and update language to confirm equal treatment of traditional and online bookings?”**

This language reflects the Council’s direction to increase the TOT to 14%.

In addition to the rate increase, since a TOT measure will be on the ballot, Council may also consider whether to make minor clarifications in the ordinance to clarify that TOT **applies fully to online hotel brokers (such as Expedia and Priceline) and “sharing economy” businesses such as Vacation Rentals By Owner (VRBO) and Airbnb.** Whether to do so is a policy matter for the Council.

The Online Travel Companies (“OTCs”) generally operate under one of two business models: the agency model or the merchant model. In the “agency” model, the OTC acts as a hotel’s agent, and recovers their service charge directly from the hotel or sometimes the customer. Under this model, the hotel collects and remits TOT based on a percentage of the full amount of money the customer is charged for the room rental (the “retail” rate). In general, the customer pays TOT on the full room rate and this tax is collected and remitted by the hotel.

Under the “merchant” model, the OTC contracts with a hotel, agreeing to pay the hotel a negotiated “wholesale” rate for a room or block of rooms. The OTC then allows customers to book rooms using its website, acting as the merchant of record in the transaction with the customer. The OTC may charge whatever it wants for room reservations and the hotel is obligated to honor reservations made through the OTC’s

website. Under this model, the OTC collects and remits TOT pursuant to its contract **with the hotel, but it only remits TOT based on the “wholesale” rate it pays the hotel, not the higher “retail” rate it charges the consumer.**

Most TOT ordinances were drafted long before the online “merchant” model became popular. OTCs have begun collecting and remitting TOT based solely on the **“wholesale” rent they pay the hotels, rather than the full “retail” rent based by the consumer.** Several cities have **sued to collect rent on the full “retail” rate but courts** have denied most of these claims. The **courts’ decisions have turned on** the particular language of the local TOT ordinance at issue. In light of this unsuccessful litigation, it is likely that many cities will begin updating their ordinances to clarify that TOT should be collected on the rent actually paid by the customer, rather than the rent collected by the hotel.

In order to ensure that the City’s TOT ordinance applies to the “merchant” model currently in practice, the Council may want to consider a discrete amendment to the **definition of “rent” in the City’s TOT.** In addition, Council may want to clarify the definition of hotel operator to confirm its application to online travel companies including Priceline, Airbnb and other similar websites or brokers. If the Committee is interested in pursuing this approach, legal staff will bring back some suggested ordinance language to the full Council. We believe modernization could be accomplished with minimal clean up language. We have included this concept in the draft ballot question, above. If Council does not wish to put these minor language changes before **the public at this time, the ballot language should end after the phrase “two percentage points.”**

Note these TOT changes are unrelated to whether AirBnb use is permitted under the **City’s Zoning Code.** The Planning Department intends to conduct a separate policy discussion next year on this broader land use issue. These changes should not be viewed as implicitly permitting hotel use that does not comply with the Zoning Code.

Polling

Should staff be directed to proceed with the proposed or revised ballot language Fairbank, Maslin, Maullin, Metz & Associates (FM3) is prepared to conduct opinion research and strategic guidance on the draft ballot language. The approximate cost for this service is \$18,000. Currently, there is \$33,500 remaining in the \$90,000 contract. The turn-around time for FM3 from the time they receive the draft ballot measure language to the time they provide polling results to the City is conservatively estimated at two weeks.

Communication Update

In March, the Palo Alto City Council voted to move forward with a TOT increase and conduct related community outreach associated with such a ballot measure. Attached is

a memo from the City's communication strategy consultant, TBWB, providing an update on that strategic outreach process (Attachment D).

Council Meeting Minutes

Attached are the March 3, 2014 City Council meeting minutes from the infrastructure discussion (Attachment E). Discussions before and after the infrastructure discussion have been redlined out for clarity as the language is not relevant to this staff report.

Attachments:

- A - Draft Infrastructure Project Funding Proposal_3-3-2014 (PDF)
- B - Reconciliation of March 3 Proposal to May 20 Proposal_5-20-2014 (PDF)
- C - Revised Draft Infrastructure Project Funding Proposal_5-20-2014 (PDF)
- D - TBWB Communication Update_5-20-2014 (PDF)
- E - Council Meeting Minutes Excerpt on Infrastructure_3-3-2014t (PDF)

DRAFT
Infrastructure Project Funding Proposal

Status Quo

Step 1
(Public Safety Building using existing funding)

Step 2
(Use remaining existing funding and 3% TOT increase)

Public Safety Building & Land	57
<u>Funding</u>	
New Hotels - COPs	33.6
FY 2013 Surplus	8.5
Stanford Funds - Infrastructure	14.9
Sum:	57



Bike Bridge	1.7
Bike/Pedestrian Plan	28.5
Byxbee Park	3.6
Cal Avenue Garage (+158 spaces)	9.6
Downtown Parking Garage (+214)	13
Fire Stations (2)	14.2
Parks Catch-up	4.6
Sum:	75.2
<u>Funding</u>	
Stanford Funds - Infrastructure	7.2
Stanford Funds - Sustainability	12.3
Stanford Funds - Interest	1.5
Parking In-Lieu Fund	4
FY 2014 Surplus (projected)	4
TOT Increase 3% - COPs	46.2
Sum:	75.2

<u>Unfunded Projects</u>	<u>Cost</u>
Bike Bridge	1.7
Bike/Pedestrian Plan	28.5
Byxbee Park	3.6
Cal Avenue Garage (+272 spaces)	16.5
Downtown Parking Garage (+214 spaces)	13
Downtown Parking Garage (+89 spaces)	5.4
Fire Stations (2)	14.2
Parks Catch-up	8.9
Public Safety Building & Land	57
Sum:	148.8



<u>Remaining Unfunded Projects</u>	<u>Cost</u>
Bike Bridge	1.7
Bike/Pedestrian Plan	28.5
Byxbee Park	3.6
Cal Avenue Garage (+272 spaces)	16.5
Downtown Parking Garage (+214 spaces)	13
Downtown Parking Garage (+89 spaces)	5.4
Fire Stations (2)	14.2
Parks Catch-up	8.9
Sum:	91.8



<u>Remaining Unfunded Projects</u>	<u>Cost</u>
Cal Avenue Garage (+114 spaces)	6.9
Downtown Parking Garage (+89 spaces)	5.4
Parks Catch-up	4.3
Sum:	16.6

<u>Existing Funding</u>	<u>Amount</u>
New hotels - COPs	33.6
Stanford Funds - Infrastructure	22.1
Stanford Funds - Sustainability	12.3
Stanford Funds - Interest	1.5
Parking In-Lieu Fund	4
FY 2013 Surplus	8.5
FY 2014 Surplus (projected)	4
Infrastructure Reserve	8
Sum:	94



<u>Remaining Existing Funding</u>	<u>Amount</u>
Stanford Funds - Infrastructure	7.2
Stanford Funds - Sustainability	12.3
Stanford Funds - Interest	1.5
Parking In-Lieu Fund	4
FY 2014 Surplus (projected)	4
Infrastructure Reserve	8
Sum:	37



<u>Remaining Existing Funding</u>	<u>Amount</u>
Infrastructure Reserve	8

City Hall Police Area Lease - COPs*	19.6
Total Sum:	113.6

- Other Factors to Consider:
- 1) Potential costs for shuttle system improvements and parking lot
 - 2) Potential cost of post office construction project
 - 3) *Infrastructure Reserve of \$8 million and projected \$19.6 million through COPs from lease of current police space upon completion of Public Safety Building project are not allocated to projects in this scenario, allowing these funds to be programmed through a future process.
 - 4) **Parking garage cost estimates are based on additional parking spaces and the City's In-Lieu Parking Fee

ATTACHMENT B

March 3 Spreadsheet to Committee & Staff's Recommend 1% Project Reductions

	-000s-		
Projects and Costs	@3% TOT	@2% TOT	Recomm. Changes
Public Safety Building	57,000	57,000	
Bike Bridge	1,700	1,700	
Bike Ped Plan*	21,000	20,000	(1,000)
Arastradero	7,500	7,500	
Byxbee Park	3,600	2,800	(800)
California Avenue Garage**	9,600	9,600	
Downtown Parking Garage**	13,000	13,000	
Fire Station(s)	14,200	6,700	(7,500)
Parks Catch-Up	4,600	-	(4,600)
Total Costs	132,200	118,300	(13,900)
1 % TOT reduction = (\$15.4) million	(15,400)	-	-
for project expenses			
New Project Total	116,800	118,300	
Sources	As of 2/24/14	As of 3/31/14	
Stanford Infrastructure (SI)	22,100	22,072	includes interest earned
Stanford Sustainability (SS)	12,300	12,400	includes interest earned
Stanford Interest	1,500	-	
Infrastructure Reserve	8,500	8,500	
FY 2014 Surplus	4,000	4,000	
Parking In-Lieu Fees by June 30, 2014	4,041	4,041	
Park Impact Fees	-	2,761	
New Hotel Revenue COPs	33,600	33,600	
TOT increase of 3%/2%	46,200	30,800	
Available revenue from TOT		126	
Grand Total	132,241	118,300	

*Potential grants not reflected in above numbers.

**Potential resources from public/private partnerships in building garages not reflected in above numbers.

ATTACHMENT C

Infrastructure Project Funding Proposal

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	Totals
Uses/Projects						
Public Safety Building		14,900		42,100		57,000
Downtown Garage		1,300	11,700			13,000
Bike Pedestrian Plan/Arastradero	1,200	3,200	7,700	7,700	7,700	27,500
Bike Bridge (gap funding)			1,700			1,700
Byxbee Park			2,800			2,800
California Avenue Garage					9,600	9,600
Fire Station		670	6,030	-	-	6,700
Total Costs	1,200	20,070	29,930	49,800	17,300	118,300
Sources						
Stanford Infrastructure		14,339	7,733			22,072
Stanford Sustainability	1,200	3,200	7,700	300		12,400
Infrastructure Reserve and FY 2014 Surplus		1,231	2,965	4,304	4,000	12,500
Downtown Parking In-Lieu Fees		1,300	2,741			4,041
Park Impact Fees			2,761			2,761
Subtotal of One-Time Funds						53,774
Finance (portions of PSB, Bike/Ped, Fire Station)		-	6,030	45,196	13,300	64,526
Total Sources		20,070	29,930	49,800	17,300	118,300

NOT INCLUDED: POST OFFICE, GOLF COURSE, AIRPORT

TO: Infrastructure Committee, City of Palo Alto
FROM: Charles Heath and Amanda Brown-Stevens, TBWB Strategies
RE: Communication Update on Funding Measure
DATE: May 20, 2014

Earlier this year, the Palo Alto City Council voted to move forward with preparing a Transient Occupancy Tax (TOT) for the ballot and conduct related community outreach. This memo summarizes outreach so far and next steps.

Drafting and Vetting Ballot Measure Language

TBWB has worked with city staff to develop draft ballot language. This has been vetted by the City Attorney's Office and is now ready for review by the Infrastructure Committee. This language will then be reviewed by Council on June 2 and tested in a tracking survey before going to the City Council in mid-June for final adoption.

Informational Voter Communication

City staff has conducted targeted outreach to community leaders and stakeholders to get input and feedback on the potential measure. In order to reach a broader audience, TBWB has drafted an informational mailer for this committee to review. This brochure will raise awareness of the city's high-priority infrastructure needs and a potential funding measure. We recommend this mailer be sent in early June before the Council makes the final decision whether to place the measure on the ballot.

A second informational mailer will be sent shortly after the Council's vote to place the measure on the ballot. This final piece will provide the details of the measure and information about voting in the election.

Tracking Research

To make any final refinements to the ballot measure and ensure support remains at a sufficient level to justify going to the ballot, a tracking poll should be conducted in early June. This will provide up-to-date opinion data that can be presented to the Council on June 16 along with the final resolution calling for the election and establishing the specifics of the measure.

Qualifying for the Ballot

To place a measure on the November 4, 2014 ballot, the City Council must adopt a resolution calling for the election no later than August 8, 2014. Accordingly, we recommend bringing the resolution to the Council for final adoption on June 16 before the Council's July recess.

Updated Schedule and Key Milestones

May

- Complete stakeholder outreach
- Infrastructure Committee meeting to review project list, ballot language and informational mailer – May 20
- Develop tracking survey to test final ballot language

June

- Present final policy direction from the Infrastructure Committee to the full City Council regarding the infrastructure plan and a potential measure on November 2014 ballot – June 2
- Mail first informational brochure – June 5
- Conduct final tracking survey
- Review survey results and adopt resolution calling for election – June 16

July

- Mail second informational mailer informing voters of the actions taken by the Council to put the measure on the ballot – third week of July

August

- City Clerk files resolution – by August 8

~~Mr. Nathan Perez responded yes.~~

~~Council Member Berman would support the Motion, because the information was sufficient.~~

~~Mr. Nathan Perez added that if the PSB were removed in two months, he would have to redo everything because the PSB was such a large project.~~

~~Council Member Klein would not support the Substitute Motion because of the language regarding the Finance Committee providing whatever portion was ready.~~

~~Mayor Shepherd would not support the Substitute Motion. Council Member Schmid articulated the situation well. The changes the Council made with regard to infrastructure would be reflected in the list without returning the item to the Finance Committee for review.~~

~~**SUBSTITUTE MOTION AS AMENDED FAILED:** 3-6 Burt, Holman, Scharff yes~~

~~**MOTION PASSED:** 8-1 Holman no~~

~~Council Member Holman inquired when Staff could provide requested information regarding fees.~~

~~Mayor Shepherd indicated Staff could provide the information outside the Council meeting due to the lack of time. She inquired whether the Council would have sufficient time to address Agenda Item Number 10, naming the Main Library.~~

~~Mr. Keene announced naming of the Main Library would be continued to a date uncertain.~~

~~**MOTION:** Council Member Scharff moved, seconded by Vice Mayor Kniss to discuss Agenda Item No. 11 prior to Agenda Item Number 9.~~

~~**MOTION PASSED:** 7-2 Schmid, Shepherd no~~

~~Mr. Keene requested a time check in at 10:00 P.M. to determine whether Staff could be excused from the meeting.~~

11. Infrastructure Project and Funding Plan.

Richard Hackmann, Management Analyst, recalled that the Infrastructure Committee met three times since the item was last before the Council on December 9, 2013. The Infrastructure Committee recommended the Council

proceed with a 3 percent Transient Occupancy Tax (TOT) increase; prioritize funding of a Public Safety Building (PSB); proceed with TBWB's, the City's communications consultant, outreach work regarding a TOT tax increase; direct the City Manager to develop a plan for a PSB; and not to perform additional surveys regarding which type of revenue measure to pursue. The Funding Plan was a list of key unfunded projects and funding sources. The main goal of the Funding Plan was to align specific infrastructure project needs with specific funding sources and demonstrate the impact of a revenue increase on the City's ability to fund certain projects. The highest priority project under the proposal was the PSB. The entire cost of a PSB would be funded through existing sources and Certificates of Participation (COPs) from existing hotel revenue. No funds from a TOT tax increase would fund a new PSB. All revenue from a 3 percent TOT tax increase would fund projects in Step 2 of the proposal. TBWB outlined a plan for public outreach and ballot language preparation, anticipating that the Council would make a final determination regarding a TOT tax increase in June 2014. The latest possible date the Council could place a ballot measure for November 2014 election was on August 4, 2014.

Council Member Klein, Chair of the Infrastructure Committee, reported the Infrastructure Committee faced literally a hundred different variables in determining infrastructure projects and funding sources. Given the number of variables, the Infrastructure Committee's proposal was not the only possible proposal. If the Council chose to add projects, then it would need to eliminate other projects with a similar dollar amount or determine ways to increase funding. The Infrastructure Committee carefully reviewed the costs of proposed projects. Fire Station Numbers 3 and 4 were both obsolete and inadequate. The Infrastructure Committee tried to coordinate its recommendations with the Capital Improvement Program (CIP). The City's consultant recommended not including an advisory measure on the ballot with a tax measure.

James Keene, City Manager, explained information contained in the spreadsheet. The list of projects totaled \$140.8 million and existing funding totaled \$113 million. The Infrastructure Committee chose to fund a PSB in Step 1 for a total of \$57 million and identified revenue of \$57 million. In Step 2, remaining unfunded projects totaled \$91.8 million and existing funding totaled \$37 million. The Infrastructure Committee selected a majority of those remaining projects for a total of \$75.2 million and utilized all the remaining funding along with the 3 percent COP to fund those projects. Projects remaining after Step 2 totaled \$16.6 million. If the Council supported the list of projects, funding sources, and a 3 percent TOT tax increase, it could accomplish virtually all infrastructure projects.

MOTION: Council Member Klein moved, seconded by Council Member Scharff to approve the Infrastructure Committee recommendation that Council approve the Infrastructure Project Funding Plan that allocates existing and potential future City funding to a prioritized project list with the recommendation to move forward with a three percentage point Transient Occupancy Tax (TOT) increase.

Council Member Scharff indicated the Council was in reach of fulfilling almost all infrastructure projects. Assuming the Motion passed, the Council could be proud it was resolving 90 percent of the infrastructure issues.

Council Member Berman felt the Infrastructure Committee's decision to prioritize a PSB and to allocate existing resources to it was remarkable. He agreed with the list of projects; however, he was not convinced that a TOT tax increase was the correct revenue measure. Currently Palo Alto's TOT tax rate was comparable to neighboring cities. If Palo Alto increased the TOT tax rate 3 percent, it would have the highest rate in the Bay Area. Palo Alto's current sales tax rate was 8 3/4 percent, the same as most other cities in Santa Clara County. San Mateo and Alameda Counties' baseline sales tax rate was 9 percent. If Palo Alto increased its sales tax rate by 1/8 cent, it would be marginally higher than other cities in Santa Clara County and lower than San Mateo and Alameda Counties. A sales tax increase warranted further study to determine the community's support. He questioned the validity of polling results for a sales tax, because of the way survey questions were asked and the list of general infrastructure projects mentioned with sales tax questions. Palo Alto could pass a TOT tax increase for anything. This could be an opportunity for the City to utilize a different revenue measure that might not be easy to pass in the future. A TOT tax increase could be utilized for future projects. There was sufficient time to poll on sales tax.

SUBSTITUTE MOTION: Council Member Berman moved, seconded by Vice Mayor Kniss to direct Staff to do another poll testing a 1/8 of a cent sales tax increase.

Vice Mayor Kniss agreed that a TOT tax increase was the easy way to generate revenue. The Council should consider a sales tax first. A sales tax increase was a way for the community to support the infrastructure projects in which the community believed. If a sales tax increase polled at 61 percent, it stood a good chance of passing. She preferred for Palo Alto to remain competitive with neighboring cities and to give the community the opportunity to support infrastructure projects.

Council Member Price would not support the Substitute Motion. Given the analysis and polling that went into compiling the report, she was comfortable

with the TOT tax increase. With the current level of economic vitality and job growth in the region, she suggested other cities were considering adjusting their TOT tax rates. The direct comparison of TOT tax costs was challenging, because other cities charged other fees that rolled into their TOT tax rates.

Council Member Burt referenced polling results for TOT tax and sales tax on page 4 of the Staff Report. The results for sales tax were marginal, and the range concerned him.

Council Member Berman noted the results Council Member Burt mentioned applied to a 1/4 cent sales tax increase.

Council Member Burt inquired whether Staff had any insights regarding polling results for 1/8 cent sales tax.

Brad Eggleston, Public Works Assistant Director, recalled survey questions asked first about a 1/4 cent increase. A follow-up question asked about a 1/8 cent increase. Polling results for the 1/8 cent increase indicated 61 percent support.

Council Member Burt asked if that was after opposing arguments.

Council Member Berman indicated the information did not provide that detail.

Council Member Klein felt a TOT tax increase would be easier to sell to the community. There was always a chance a tax could lose in a vote. A sales tax increase had a greater chance of losing. If the community voted against a revenue measure, the Council would not propose another measure the following year. If a sales tax measure lost, it could be five years before the Council could propose another revenue measure for infrastructure projects. The projects went to the heart of public safety and parking problems. The Council could not take the risk of a sales tax measure failing. Some of the same arguments were made when the TOT tax was last increased.

Mayor Shepherd requested Council Member Klein address the Substitute Motion.

Council Member Klein indicated the choice for the Council was a sales tax increase or a TOT tax increase. When the Council last increased the TOT tax, other cities increased their TOT tax rates to match Palo Alto's rate. That would likely happen again.

Council Member Schmid preferred a bond issue for public safety; however, the Council was moving toward COPs supported by the City's most dynamic

tax. He assumed the revenue measure would be a general tax which required 50 percent support on a referendum. He asked if application of revenue from the tax would be guaranteed in some way or at the discretion of the Council.

Joe Saccio, Assistant Director of Administrative Services, reported Staff programmed into the spreadsheet revenues that were based on conservative assumptions for occupancy and the daily rate. Based on current TOT tax collections, revenue could be 30 percent higher than stated in the spreadsheet. Staff included a cushion between the amount of TOT tax expected and the amount dedicated to funding infrastructure projects.

Council Member Schmid asked if the Council was guaranteeing a certain amount of money would be spent each year.

Mr. Saccio explained that the General fund was responsible for paying debt service. Staff hoped the conservative projection of funding level would be sufficient to pay debt service in a depressed economy.

Council Member Schmid inquired whether the Council was stating that public safety needs were associated with the tax increase.

Mr. Saccio clarified that a portion of funding for public safety would come from new hotel revenues.

Council Member Schmid requested a definition of new hotel.

Mr. Saccio reported new hotels were those identified with estimated opening dates.

Mr. Keene indicated new hotels were those approved and/or under construction. If a developer proposed a new hotel project, it would be beyond the proposal.

Council Member Schmid noted the General Fund would be required to pay debt service if TOT tax revenues decreased. He asked if recent questionable sales tax revenues were considered in the ten-year financial forecast.

Mr. Saccio reported the unique sales tax revenues received at the end of Fiscal Year 2013 and beginning of Fiscal Year 2014 were not used as a basis for the forecast.

Council Member Schmid inquired whether the Council was going into an election with the expectation that the City was healthier than it really was.

Mr. Saccio responded no.

Council Member Schmid asked if the General Fund had the flexibility to meet unexpected needs if a period of no growth occurred in the future.

Lalo Perez, Chief Financial Officer and Administrative Services Director, explained that situation would be no different than the period in 2009 and 2010 when Staff and the Council restructured the General Fund.

Mr. Keene noted the Infrastructure Committee left an \$8 million Infrastructure Reserve amount unallocated to handle unexpected expenditures or unexpected revenue flows.

Mr. Perez added that the present and prior Councils were prudent in managing the Budget Stabilization Reserve (BSR). The Council could choose to decrease the target percentage for the BSR to bridge any adjustments. The City was well positioned to adjust for cyclical downturns.

Council Member Schmid stated the list did not contain the lease of the existing PSB in the amount of \$19 million.

Mr. Keene clarified that the potential lease amount was technically unallocated future funding.

Council Member Schmid commented that in three or four years the lease amount could be a flow of income to help the reserve.

Mr. Keene reported revenue from a lease was more likely to occur in six or seven years.

Council Member Schmid noted the Golf Course reconstruction could impact the General Fund, and asked if that would affect an election.

Mr. Perez noted the Golf Course reconfiguration and the Post Office acquisition were concerns. Staff was considering borrowing from the Stanford University Medical Center Fund to bridge funds needed for the Golf Course or Post Office. Funds generated by COPs would reimburse the Stanford University Medical Center Fund.

Council Member Schmid inquired whether the Substitute Motion called for a 1/8 cent sales tax increase and a 2 percent TOT tax increase.

Council Member Berman replied no.

Council Member Schmid believed a 1/8 cent sales tax increase by itself would not cover expenses; therefore, a 2 percent TOT tax increase would still be needed.

Council Member Berman disagreed.

Mayor Shepherd requested Council Members remain on point in the discussion.

Council Member Schmid reiterated that a 1/8 cent sales tax increase would substitute for a TOT tax increase.

Council Member Scharff understood the Substitute Motion would produce \$43.4 million less than the Motion. A 3 percent TOT tax increase would create \$79.8 million.

Mr. Keene clarified that the 3 percent TOT tax increase created \$46.2 million.

Council Member Scharff asked if the revenue amount was from all hotels.

Mr. Hackmann explained that tax revenue included the new hotels coming online in addition to the TOT tax increase.

Mr. Keene added that revenue was more than just the 3 percent marginal increase.

Council Member Scharff stated the difference then was \$10 million.

Mr. Keene reported a 3 percent TOT tax would generate \$46.2 million and a 1/8 cent sales tax increase would generate \$36.4 million.

Council Member Scharff believed the Council would need to reduce projects by \$10 million under a 1/8 cent sales tax increase.

Council Member Holman remarked that a sales tax increase was not as certain as a TOT tax increase, and inquired whether a sales tax increase could be placed on the ballot with a TOT tax increase.

Mr. Keene reported the general feeling was negative regarding two measures on one ballot.

Mr. Eggleston recalled the consultant stated a measure with the polling level of sales tax probably would fare poorly if accompanied with another measure.

Mayor Shepherd liked the Infrastructure Committee's recommendation because it accomplished almost all projects. The Council should proceed with a strong statement of how it would collect revenues in order to catch up infrastructure needs. A TOT tax increase was compelling.

SUBSTITUTE MOTION FAILED: 2-7 Berman, Kniss yes

AMENDMENT: Council Member Berman moved, seconded by Council Member Burt to change the TOT tax increase from three percent to two percentage point.

Council Member Berman felt increasing the TOT tax rate to the same rate charged in San Francisco was more palatable than having the highest rate in the Bay Area. A 2 percent TOT tax increase created \$15 million less revenue than a 3 percent increase; therefore, the Council would have to find \$15 million in funding or move \$15 million in projects to the CIP. The only unfunded project he wanted to fund was parks catch-up in the amount of \$4.3 million. With respect to cash flow concerns, not all projects would be constructed at the same time which would allow funds to be utilized for cash flow. He could accept allocating the \$8 million Infrastructure Reserve to some projects or to bridge a funding gap. Low priority projects could be transferred to the CIP.

Council Member Burt agreed that revenue projections were conservative. Based on his calculations, revenue from the lease of the existing PSB would cover the gap between a 2 percent and 3 percent TOT tax increase. Additional funds could be found in Staff's conservative projections for revenue. Therefore, the City had sufficient funds to meet the capital goals of Step 2 with a 2 percent TOT tax increase. Exceeding the highest TOT tax in the region could harm Palo Alto's reputation.

Council Member Holman supported the Amendment. Having the highest TOT tax rate did not reflect well on Palo Alto's image. Other communities would raise their TOT tax rates if Palo Alto increased its rate.

Council Member Scharff did not believe a 2 percent TOT tax increase would accomplish all projects as construction costs and land prices continued to increase. Any notion that people would not stay in Palo Alto because of a TOT tax increase was illogical.

Vice Mayor Kniss felt a high TOT tax rate could be perceived as Palo Alto treating visitors callously. However, the community would support a TOT tax increase. It was important for the Council to agree on an amount to recommend to the community, because the community needed to feel the Council was in unison.

Council Member Klein initially favored a 2 percent TOT tax increase; however, he was persuaded in during the Infrastructure Committee that a 3 percent increase was necessary. The Infrastructure Reserve may be needed for cash flow differentials. He did not recommend use of funds from a lease

of the existing PSB, because the revenue was too far in the future. Other cities had a TOT tax rate in excess of 15 percent. He favored a TOT tax rate of 14 percent, because it would accomplish all projects.

Council Member Price felt strongly the TOT tax increase should be 3 percent. This was an opportunity for the Council to accomplish infrastructure projects. She anticipated other cities would increase their TOT tax rates if Palo Alto did so. The reputation of Palo Alto would not be affected by an increase in the TOT tax rate. The improvements would have a positive effect on Palo Alto's reputation.

Mayor Shepherd wanted to accomplish all infrastructure projects. If the increase was only 2 percent, the Council ran the risk of not accomplishing all projects. A TOT tax increase would not affect the number of people staying in Palo Alto.

Council Member Holman requested clarification of, "the Infrastructure Project Funding Plan."

Council Member Klein called point of order.

Mayor Shepherd indicated the Motion was contained within the Amendment.

Council Member Klein explained the Amendment changed 3 percent to 2 percent only. Council Member Holman could speak to the Motion after a vote on the Amendment.

AMENDMENT PASSED: 5-4 Price, Scharff, Schmid, Shepherd, no

Council Member Holman stated that "Infrastructure Project Funding Plan" was vague. She suggested "Infrastructure Project Funding Proposal as included in the March 3, 2014 Staff Report" to clearly identify the document under discussion.

Mr. Keene agreed the language change provided clarity; however, the document was \$10 million short in funding.

Council Member Holman reiterated that the Motion was vague with respect to the document being discussed even though it would need to be amended in the future.

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER to change the following language in the main Motion, "Infrastructure Project Funding Plan" to "Infrastructure Project Funding Proposal as included in the March 3, 2014 Staff Report."

MOTION AS AMENDED PASSED: 9-0

MOTION: Council Member Klein moved, seconded by Mayor Shepherd to refer this back to the Infrastructure Committee to consider changes in light of reducing the TOT Tax from 3 percent to 2 percent.

MOTION PASSED: 9-0

~~Mayor Shepherd noted that Agenda Item Number 9, Comprehensive Plan Update, would be continued.~~

~~9. Comprehensive Plan Update Revised Approach, Schedule, Scope of Work, and Contract Amendment in the amount of \$597,206 with The Planning Center | DCE for Consultant Support Related to the Ongoing Update of Palo Alto's Comprehensive Plan for the Future of Our City.~~

~~**MOTION:** Council Member Scharff moved, seconded by Vice Mayor Kniss to move Agenda Item No. 10 "From Policy & Services Committee Staff requests direction from Council on the naming of the Mail Library" to a date in March 19, 2014.~~

~~Council Member Klein requested a date certain for discussion of naming the Main Library. The Library Director previously indicated the matter was time sensitive.~~

~~Mr. Keene reported naming the Main Library could be placed on the March 17 or 24, 2014 Agenda.~~

~~**MOTION PASSED: 7-2 Schmid, Shepherd no**~~

~~10. From Policy and Services Committee Staff Requests Direction From Council on the Naming of the Main Library.~~

~~ADJOURNMENT: The meeting was adjourned at 11:09 P.M.~~