



# City of Palo Alto

## City Council Staff Report

(ID # 4872)

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**Report Type: Action Items**

**Meeting Date: 6/2/2014**

**Summary Title: Funding Proposal, Preliminary TOT Approval, and Polling Authorization**

**Title: Review and Approval of the Revised Draft Infrastructure Project Funding Proposal, Preliminary Approval of the Transient Occupancy Tax Ballot Language, and Authorization to do Final Polling on the Transient Occupancy Tax and Utilities User Tax Modernization Measures**

**From: City Manager**

**Lead Department: City Manager**

### **Recommendation**

Staff recommends that Council review and approve the revised draft infrastructure project funding proposal, provide preliminary approval of the transient occupancy tax ballot language, and give staff authorization to do final polling on the transient occupancy tax measure and utilities user tax modernization measure.

### **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 for consideration of changes to the \$132.2 million project list in light of the reduction in proposed TOT funding.

### **Revised Draft Infrastructure Project Funding Proposal**

Reconciliation between the draft infrastructure project funding proposal presented to Council on March 3, 2014 and the Infrastructure Committee's revised draft infrastructure project funding proposal is attached for your review (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 the Infrastructure Committee to close the funding gap created by the reduction in the proposed TOT increase, and the funding sources required for the infrastructure work.

To close the \$15.4 million gap, staff recommended to the Infrastructure Committee that the following projects be reduced or postponed from the \$132.2 million plan. As seen below, the reduction proposed by staff at the May 20, 2014 Infrastructure Committee meeting is not \$15.4 million but instead \$13.9 million. This is because staff was able to identify an additional \$1.5 million in funding to help offset the TOT reduction.

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 reducing 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 the proposed Byxbee Park improvement 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.

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

Following Committee review, and a presentation by staff on future revenue sources not identified, available, or allocated at the time of the original staff report, the Infrastructure Committee recommended that the City Council approve the revised draft infrastructure project funding proposal, including the reductions recommended by staff, with the exception of retaining Fire Station 4 in the revised draft infrastructure project funding proposal to be funded by future revenue source(s). Examples of potential future revenue sources include, but are not limited to, increases in revenue from a revised utility users tax (UUT), future development impact fees, and Police Building rent revenue once the new Public Safety Building (PSB) is constructed.

A summary of the revised list of projects proposed for postponement by the Infrastructure Committee is below.

<b>Committee Projects Proposed for Postponement</b>	<b>Reduction (in millions)</b>
Bike/Pedestrian Master Plan	\$1
Parks Catch-Up	\$4.6
Byxbee Park	\$0.8
<b>Total</b>	<b>\$6.4</b>

The recommendation to reduce the three percentage point TOT increase to a two percentage point TOT increase has resulted in the postponement of \$6.4 million worth of projects. Staff feels this is an aggressive, but realistic, reduction plan. The result of this is \$125.8 million of the \$132.2 million worth of projects proposed to Council on March 3, 2014 (under the assumption of a three percentage point TOT increase) will still be constructed despite a \$15.4 million reduction in TOT revenue.

To demonstrate that adequate resources are available for \$125.8 million in infrastructure work please see the revised draft infrastructure project funding proposal (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 since its inception, such as Stanford Development Agreement funds and Infrastructure Reserve monies. The use of these funds is shown by year.

**\$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 tax receipts and the two percentage point TOT increase.

The final \$7.5 million for Fire Station 4 will be funded by future revenue sources including, but not limited to, increases in revenue from a revised UUT, future development impact fees, and Police Building rent revenue once the PSB is constructed.

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.

When the new PSB is built a new revenue stream will be generated by renting the old Police Building located at City Hall. Once completed and occupied, the old Police Building is conservatively estimated to yield \$1.4 million annually.

There are; however, multiple 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 in the short-term.

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, despite it being an aggressive plan 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 Ballot Language: Rate Increase and Language Update**

Below is draft ballot language prepared by the City Attorney's Office and recommended by the Infrastructure Committee:

1. **"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, staff recommended, and the Infrastructure Committee agreed, that it would be prudent to use the opportunity of a ballot measure on the TOT to update the TOT ordinance to clarify that the tax applies fully to online hotel brokers (such as Expedia and Priceline) and "sharing economy" businesses such as Vacation Rentals By Owner (VRBO) and Airbnb.

**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. Palo Alto's existing TOT ordinance adequately addresses the "agency" model of online bookings.**

**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 typically only remits TOT based on the "wholesale" rate it pays the hotel, not the higher "retail" rate it charges the consumer.**

**This is because most TOT ordinances were drafted long before the online "merchant" model became popular, and therefore do not clearly address the new pricing practice. 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. Staff recommends that the TOT be updated to ensure that the City's TOT ordinance applies to the "merchant" model of online bookings.**

In addition, staff recommends updating the TOT language to confirm that online intermediaries or brokers (including Airbnb) are responsible to collect the tax. (Note this TOT update is unrelated to short-term rentals of homes, condos or apartments, in whole or in part, 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. The proposed TOT update is not intended and should not be viewed as implicitly permitting use of structures as hotels where such use does not comply with the Zoning Code.)

Staff will bring the suggested ordinance language to the full Council for approval on June 16, 2014 along with the Resolution calling the election.

### **Polling**

Staff recommended and the Infrastructure Committee agreed that Fairbank, Maslin, Maullin, Metz & Associates (FM3) should conduct a final round of opinion research on the draft ballot language for both the TOT increase and the UUT clean-up (which has already been approved by Council). FM3 would poll on these two ballot questions:

1. **"Shall the City of Palo Alto adopt an ordinance to reduce the tax rate for the telecommunications portion of the Utility Users Tax (which helps fund basic City services and projects) from 5% to 4.75%; modernize its provisions to ensure equal treatment of taxpayers regardless of telecommunications technology used; and eliminate a discounted tax rate paid by a small number of commercial large users of gas, electric and water services?"**
2. **"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?"**

The approximate cost for this service is \$20,000. Currently, there is \$33,500 remaining in the \$90,000 FM3 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 but likely less.

### **Infrastructure Committee Motions**

Below are the motions approved by the Infrastructure Committee at their May 20, 2014 meeting:

#### Motion 1

Chair Klein moved, seconded by Council Member Burt, that the Infrastructure Committee recommend the City Council 1) approve the revised draft infrastructure project funding proposal, 2) approve the draft transient occupancy tax ballot language, and 3) provide direction on whether additional polling should occur including the following changes:

- 1) Retention of Fire Station 4 in the revised draft infrastructure project funding proposal

- 2) Reduction of \$1 million for the Bike/Pedestrian Plan;
- 3) Reduction of \$4.6 million in parks catch-up;
- 4) Reeducation of \$0.8 million in Byxbee Park funding to be covered by other sources such as COPs and/or Development Impact Fees.

Motion Passed: 3-1 with Scharff dissenting

#### Motion 2

Council Member Burt moved, seconded by Council Member Berman, that the Infrastructure Committee approve the transient occupancy tax ordinance with updated changes to reflect the full retail rent and the rent be redefined to include any form of merchant of short-term occupancy rental.

Motion Passed: 4-0

#### Motion 3

Council Member Berman moved, seconded by Council Member Scharff for the Infrastructure Committee direct Staff to poll for the transient occupancy tax and Utilities users tax modernization.

Motion Passed: 4-0

Also, attached for your review, is the most recent TBWB update (Attachment D).

#### **Attachments:**

- A - Infrastructure Project Funding Proposal\_3-3-2014 (PDF)
- B - Draft Infs Project Funding Proposal vs Revised Draft Infs Project Funding Proposal\_5-20-2014 (PDF)
- C - Revised Draft Infrastructure Project Funding Proposal\_5-20-2014 (PDF)
- D - TBWB Communication Update\_5-20-2014 (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)

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

<b>Bike Bridge</b>	1.7
<b>Bike/Pedestrian Plan</b>	28.5
<b>Byxbee Park</b>	3.6
<b>Cal Avenue Garage (+158 spaces)</b>	9.6
<b>Downtown Parking Garage (+214)</b>	13
<b>Fire Stations (2)</b>	14.2
<b>Parks Catch-up</b>	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**

**Draft Infs. Project Funding Proposal vs. Revised Draft Infs. Project Funding Proposal**

	-000s-		
<b>Projects and Costs</b>	<b>@3% TOT</b>	<b>@2% TOT</b>	<b>Recommend Changes</b>
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 Stations	14,200	14,200	
Parks Catch-Up	4,600	-	(4,600)
<b>Total Costs</b>	<b>132,200</b>	<b>125,800</b>	<b>(6,400)</b>
<b>1 % TOT reduction = (\$15.4) million for project expenses</b>	<b>(15,400)</b>	<b>-</b>	<b>-</b>
<b>New Project Total</b>	<b>116,800</b>	<b>125,800</b>	
<b>Sources</b>	<b>As of 2/24/14</b>	<b>As of 5/20/2014</b>	
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	
Future Revenue Sources TBD***		7,500	
<b>Grand Total</b>	<b>132,241</b>	<b>125,800</b>	

\*Potential grants not reflected in above numbers.

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

\*\*\*Potential future revenue sources may include, but are not limited to, increases in UUT revenue , development impact fees, and and Police Building rent revenue.

## ATTACHMENT C

### Revised Draft Infrastructure Project Funding Proposal

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	Totals
<b>Uses/Projects</b>						
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 3		670	6,030	-	-	6,700
Fire Station 4						7,500
<b>Total Costs</b>	<b>1,200</b>	<b>20,070</b>	<b>29,930</b>	<b>49,800</b>	<b>17,300</b>	<b>125,800</b>
<b>Sources</b>						
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
<b>Subtotal of One-Time Funds</b>						<b>53,774</b>
<b>Finance (COP's)</b>		-	<b>6,030</b>	<b>45,196</b>	<b>13,300</b>	<b>64,526</b>
<b>Future Revenue Sources TBD</b>						<b>7,500</b>
<b>Total Sources</b>		<b>20,070</b>	<b>29,930</b>	<b>49,800</b>	<b>17,300</b>	<b>125,800</b>

***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

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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