



City of Palo Alto

City Council Staff Report

(ID # 10615)

Report Type: Action Items

Meeting Date: 9/16/2019

Summary Title: Evaluation and Discussion of Potential Revenue Generating Ballot Measures and Budget Amendment

Title: Evaluation and Discussion of Potential Revenue Generating Ballot Measures and Confirmation of Finance Committee Recommended Parameters for Tax Structure and Further Analysis; and Approval of a Budget Amendment in the General Fund

From: City Manager

Lead Department: Administrative Services

Recommendation

- 1) The Finance Committee and staff recommend that the City Council review, provide comments and direct staff to continue work regarding a potential revenue generating ballot measure with the following parameters:
 - a. Consider a general business tax measure focused on head count or square footage as the units of measure;
 - b. Consider a parcel tax measure focused on square footage as the unit of measure;
 - c. Potential revenue proceeds allocations to transportation and/or affordable housing shall be determined at a later date and informed by polling;
 - d. Continue further refined analysis on potential exemptions and tiered tax rate structures with the following guidance: maintaining estimated revenue generation between 1 and 6 percent of General Fund revenues, focus on implications regarding retail, restaurants, hospitality, and medical industries, and keeping potential tax structures simple and modern minimizing exemptions;
 - e. Continue to review any potential ballot measures as either a general tax (with non-binding advisory language on intended use of funds) or a special tax measure; and
 - f. Consider a parcel tax or General Obligation (GO) Bond for unfunded infrastructure projects at a later date; and
 - g. Discuss next steps including continued stakeholder engagement and potential polling.

- 2) Staff recommends that the City Council amend the Fiscal Year 2020 Budget Appropriation Ordinance for the General Fund by:
 - a. Increasing the Administrative Services Department appropriation for contractual services in the amount of \$75,000; and,
 - b. Decreasing the Budget Stabilization Reserve in the amount of \$75,000.

Summary

This report transmits to the full City Council work that began as part of the 2019 Fiscal Sustainability workplan approved by Council in April 2019 and has been reviewed and discussed by the Finance Committee beginning in June 2019 regarding potential revenue generating ballot measure(s). Included in the body of this report is a high-level summary of the work completed by staff with the Finance Committee to-date. Staff and the Committee are seeking the full Council's review and approval of the progress made thus far and confirmation of the identified next steps and focus of continued staff work on potential revenue generating ballot measure(s).

As was outlined in the original workplan for this effort, it is staff's intent that this be an iterative process providing information at a steady pace and allowing for continued review and refining of proposals and analysis. As directed by Council, the Finance Committee serves as the working body to assist in the review of potential revenue generating initiatives and provide recommendations for consideration and action by the City Council.

Background

The Finance Committee and staff have been working to evaluate potential revenue generating proposals, in alignment with the 2019 Fiscal Sustainability work plan (City Manager Report #10267: www.cityofpaloalto.org/civicax/filebank/documents/70506) and secondary workplan for a potential revenue generating ballot measure (City Manager Report #10261: www.cityofpaloalto.org/civicax/filebank/documents/70507) that were both approved in April 2019 by Council. Below summarizes the two meetings that have been held with the Finance Committee:

June 18, 2019 Finance Committee Meeting: Review, Comment, and Accept Preliminary Revenue Estimates for Consideration of a Ballot Measure

City Manager Report #10392:

www.cityofpaloalto.org/civicax/filebank/documents/72101

Action Minutes:

www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=53170.55&BlobID=73283

Sense Minutes:

www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=53170.55&BlobID=73285

In the Finance Committee’s first iterative discussion in June, the Committee considered all potential tax options, which include a parcel tax, issuance of a General Obligation (GO) Bond, a sales and use tax increase, a transient occupancy tax increase, a documentary transfer tax increase, a utility users tax increase, and several business tax structures. A detailed description of the various taxes the City of Palo Alto collects, some general information about the taxes and the drivers for them, and lastly potential revenue increases that could be seen if the tax rates were changed, or a new tax was imposed.

At this meeting the Committee aided in narrowing the more refined analysis of staff to three types of tax measures:

- GO Bond issuance
- Parcel Tax
- Business Tax: Employee Head Count, Square Footage, and Payroll Expense

Though ultimately not included, there was some discussion and desire to potentially continue to include a Sales Tax measure as well. The Committee agreed to the use of a framework to help think through potential measures, E.A.S.E.:

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| EQUITY | Who does the tax impact and how is the impact felt across all residents or businesses in the same industry? |
| ADMINISTRABILITY | How is the tax administered and what would be the cost of compliance on taxpayers and the City? |
| STABILITY | What are the drivers of the tax revenue and how does the tax type in question affect the volatility of the revenue over time (including potential recessionary or modernization scenarios)? |
| ECONOMIC BENEFITS | Is the tax efficient, promotes economic development objectives and minimize disruption on the taxpayer? |

June 18, 2019 Finance Committee Additional Resources:

- Video: midpenmedia.org/finance-committee-50-6182019-2/
- Presentation: www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=42443.89&BlobID=72200

August 20, 2019 Finance Committee Meeting: Evaluation and Discussion of Potential Revenue Generating Ballot Measures

City Manager Report #10455:
www.cityofpaloalto.org/civicax/filebank/documents/73071

Action Minutes:
www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=53148.14&BlobID=73282

Staff returned to the Finance Committee and provided increasingly detailed and complex analysis. It focused on the narrowed parameters provided by the Committee and provided additional context on past election results; legal restrictions and concerns; a high-level, estimated range of revenue the tax will generate; the City's and comparable agencies' employment and industry trends, and other relevant information that may be of value to the Finance Committee and stakeholders. The E.A.S.E. framework is discussed under each revenue type so that these principals can be considered as policy decisions are considered during the process. Detailed analysis is included for the following:

- GO Bond issuance: scenarios ranging from \$100 million in debt issuance to \$500 million in debt issuance. A GO Bond would require 2/3 voter approval.
- Parcel Tax: models two potential units of measure, a flat rate or a rate by square footage. Parcel Taxes typically require 2/3 voter approval.
- Business Tax: models three potential units of measure, employee head count, square footage, and payroll expense. Staff received assistance from a consultant firm to complete extensive benchmarking of business taxes in various jurisdictions which is included in this report. Business Taxes may be a general (majority voter approval) or a special (2/3 voter approval) measures.

As noted above, the City engaged Matrix Consulting Group (Matrix) to conduct research that will assist in development of a potential business license tax. The scope of the engagement included:

- comparative research of selected Bay Area communities to understand each agency's business license tax practices regarding the development, implementation, and administration of each program; and
- performance of data analysis and modeling, based on available data resources, of the potential revenue range the City may generate if a business license tax measure were to be approved by the voters.

August 20, 2019 Finance Committee Additional Resources:

➤ Video: www.midpenmedia.org/finance-committee-50-8202019/

➤ Presentation:

www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=72721.13&BlobID=73127

Discussion

In the most recent August discussion with the Finance Committee, the Committee heard from staff, the City's consultant, and members of the public, and spent hours discussing the more refined revenue estimates and potential intricacies of tax structures and implications. The Committee focused on four areas for discussion and further narrowed staff's future focus as outlined below.

- A. The type(s) of tax measures that staff should continue to focus on for further analysis and research.
- *Continue to evaluate a general business tax based on either head count or square footage as the metric as well as a parcel tax based on square footage.*
 - *Specifically, expand benchmarking of other cities to include identification of data sources used to audit and/or regulate the tax.*
- B. Evaluation and articulation of the types of tax structure, such as potential exemptions (beyond those legally required), and flat rate versus tier pricing structures.
- *Continue to evaluate both flat and tiered pricing structures.*
 - *Maintain ultimate revenue generation between 1 percent and 6 percent of General Fund revenues.*
 - *Analysis and costing for exemptions, focusing on those legally required by state/federal law, as well as exemptions for public utilities, hospitality, retail, restaurants, and small medical facilities/clinics.*
- C. Major characteristics of a potential tax, such as a phase-in of a new tax, both implementation period as well as rate phase-in, or sunset provision ending the tax after a certain period.
- *Continue further analysis evaluating both a general tax (with non-binding advisory language on intended use of funds) or a special tax measure and the legal parameters of these.*
 - *If necessary, phase-in a new tax rate looking at impact on average business.*
 - *Keep a focus on a manageable structure, limiting complexities, however, address the modern economic climate and realities; for example definition of an “employee” under a headcount-based tax. Provide additional comparable data on definitions such as this.*
- D. Discuss the potential uses of taxes.
- *Provide an itemized list of potential City funding needs (similar to that provided in the annual Long Range Financial Report) matrix to evaluate uses of taxes versus those whom the tax would be levied on.*
 - *The highest immediate priorities would be to levy a general business tax or similar for transportation and/or housing investments.*
 - *At a later date, consider a parcel tax or GO Bond for unfunded infrastructure projects.*

While the Committee provided recommendations on the costing for certain limited exemptions, the Committee deferred full discussion of desired exemptions to allow for review of potential financial conflicts of interest. That review is ongoing. The discussion of exemptions by Council at this meeting may be similarly limited or structured to maximize participation by Councilmembers in light of conflict of interest requirements.

As of the drafting of this report, the above items are currently being researched and compiled by staff and Matrix. Staff plans to provide the Finance Committee and Council with this information in the next phase of the process.

Next steps in this process will be to continue to review and discuss with the Finance Committee, City Council and stakeholders, narrowing the focus of further staff analysis so that more complex scenarios can be modeled including adjusting for any potential exemptions in addition to the legally mandated ones, more analysis on different pricing levels and structures, and implications on parties and industries that would be assessed an increased or new tax. As the focus of further staff analysis is narrowed, more discrete analysis and discussion of implications such as potential areas of tax leakage and impacts on the economic environment and tax ecosystem will be more viable and informative.

Timeline

As outlined in the original workplan, staff anticipate an iterative process as the Finance Committee and the Council evaluate potential revenue generating measure. It is expected that after this meeting, staff will return to the Finance Committee to continue to refine and analyze potential tax measures. The workplan stipulates polling and stakeholder outreach to be completed when ready and appropriate. Ultimately, the current workplan outlines a decision by October/November on the core attributes of what type of measure to pursue including the major variables for it to be based on.

Resource Impacts

The 2019 Fiscal Sustainability workplan identified this project as one that was not resourced by either staffing or consultant funding. Staff have been absorbing this work with the assistance of a consulting firm. As outlined in previous reports, this report recommends increasing contractual appropriated funds to ensure sufficient budgeted funds for both consultant assistance completed to date as well additional costs in order to complete this additional analysis outlined in this report. Current consulting costs are estimated at \$50,000 and staff is working with the consultant to evaluate additional costs in relation to the work outlined above. Therefore, staff recommends a budget adjust of \$75,000.

Minor costs associated with the procurement of data have been incurred and will be absorbed by the Administrative Services Department. Additional funds beyond those outlined in this report may be necessary depending on future requests for additional analysis as well as potentially future polling and/or citizen engagement.

Environmental Review

This report is not a project for the purposes of the California Environmental Quality Act (CEQA). Environmental review is not required.