



City Council AGENDA REPORT

DATE: 02/19/2022

AGENDA OF: 03/08/2022

DEPARTMENT: City Council

SUBJECT: Resolutions Requesting the Placement of a Sales and Use Tax Ballot Measure on the June 2022 California Statewide Primary Election (CN)

RECOMMENDATION: Motion to:

- 1) Accept a report regarding the recent work of the City Council Ad Hoc Revenue Committee; and
 - 2) Adopt a resolution making emergency findings for placing a general purpose one-half of one percent retail transactions and use tax measure on the June 7, 2022 election; and
 - 3) Adopt a resolution requesting that the consolidated June 2022 California statewide primary election include a general purpose one-half of one percent retail transactions and use tax measure; and
 - 4) Support the measure for the purpose of authorizing arguments; provide direction regarding the authors; directing the City Attorney to prepare the impartial analysis; and providing direction to the City Manager regarding the preparation of the fiscal analysis, as appropriate.
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BACKGROUND: With a backdrop of the COVID-19 on-going pandemic and the local CZU Lightning Complex Fire, the City faced sweeping impacts to its economy and fiscal position. Despite years of responsible and proactive fiscal management and multiple years of static and reduction-based budgets, with the unprecedented recession impacts of the above mentioned disasters, the City now faces structural deficits – even once the American Rescue Plan Act (ARPA) funds are accounted for in FY 2021 and FY 2023¹. The one-time infusion of federal funds and projected revenue recovery will help the City in the short-term, but many issues pose ongoing challenges for the City, including long-term structural deficits from state pension investment shortfalls, increases to core costs, significant deferred infrastructure maintenance, and needs for expanded and new services.

In the past two years, the City faced dramatic reductions in revenues while having to respond to the disasters and maintain essential services. With respect to the General Fund, the City saw a

¹ The City of Santa Cruz received its first of two equal ARPA tranches in the amount of \$7.1M in June 2021. The second payment of \$7.1M is currently expected to be received by the City sometime in June or July 2022.

loss of \$10 million in FY 2020 and a loss of \$11 million for FY 2021. Prior to the start of FY 2022, budget projections estimated that revenues would begin to recover, but would remain approximately \$6 million less than previously estimated. Tourism/visitor-related revenues saw a sharp reduction. Transient Occupancy Tax revenue dropped by 33% over the two-year period, and Admission Tax revenue plunged an incredible 97%. The City froze hiring and encouraged early retirements. City employees stepped up to these challenges, and for FY 2021, most employee groups took a 10% salary reduction through furloughs. These sacrifices resulted in approximately \$7 million in savings. As the effects of the pandemic continued, in October 2020, the City Council adopted a revised budget that resulted in another \$5 million in cuts. The City's General Fund reserves decreased 32% from FY 2019 to 2021 (not including American Rescue Plan funding).

The first round of stimulus funding was allocated in December 2020. The approximately \$784,000 was used to address the added costs of responding to the pandemic. The ARPA funds of ~\$14.2 million will help stabilize the budget and, being one-time funding, it will provide interim stability to the City - allowing the deferral of additional reductions; replenishing reserves; and, essentially, allowing the City the time to develop and implement a longer-range fiscal sustainability plan. It will not close our significant structural deficit or fully restore the massive revenue gaps brought on by the pandemic.

On January 12, 2021, during its annual appointment of representatives to external agencies, groups, Council committees, and task forces, the Council retired the FY 2021 focused Council Ad Hoc Budget Committee and established a Council Ad Hoc Revenue Committee (Committee) to explore and recommend revenue-enhancing options to address the City's structural deficit. Subsequently, then Mayor Meyers appointed herself, then Vice Mayor Brunner, and Councilmember Cummings to serve on the Committee.

The Committee initially focused on exploring revenue options in order to narrow down to a potential recommendation for Council and did the following:

- Read up on the basics of municipal revenue in California for cities, counties and special districts via the Institute for Local Government's 2016 white paper (Attachment 1).
- Researched and considered California local revenue measure results for November 2020 (Attachment 2).
 - o Passage rates
 - o Outcomes by category
 - o City, county and special district measures
- Explored various revenue sources including:
 - o Property tax
 - o Sales and use taxes:
 - Business license tax
 - Parcel tax
 - Sales tax
 - Transfer tax
 - Transient occupancy tax
 - Utility users tax
 - Vacancy tax
 - o Service charges, assessments and fees
 - Development impact fees
 - Regulatory fees
 - Utility rates

- User fees
- Rent for use of public property
 - Rents, royalties, and concessions
 - Franchise fees

In the service charges, assessments and fees space, Parks & Recreation and Planning & Community Development have both embarked on a review and revamp of their respective fees to determine how best to balance service delivery with cost recovery. Those efforts are ongoing and updates will be provided to Council. At the April 13, 2021 Council meeting, several Departments brought forward for Council consideration development fee adjustments for system development changes, sewer connections, child-care impacts, and public safety impacts. All proposed changes were adopted by Council and will help the City toward fiscal sustainability.

However, even with these efforts, the City must still address the ongoing structural deficits as well as fund recovery efforts, shore-up critical services, invest in aged and decayed infrastructure, and implement current and future directed changes in business support, housing, homelessness response, fire prevention, and safety improvements for streets, sidewalks and public facilities.

In June 2021, the full Council considered the recommendation of the Committee to move forward with a sales tax measure on the November 2021 ballot but was unable to reach unanimity to declare the required fiscal emergency². As the pandemic continued with the delta then omicron variants, and with the structural financial gaps still in existence, the Committee reconvened in November 2021 after the larger Council received a financial status update.

As of November 2021, the City’s General Fund (GF) available balance as compared to reserve goals³ are shown below in Figure 1, along with the same information translated to a deficit basis to show the City’s estimated deficits ranging from \$6 million to \$15 million in the coming fiscal years (Figure 2).

Figure 1

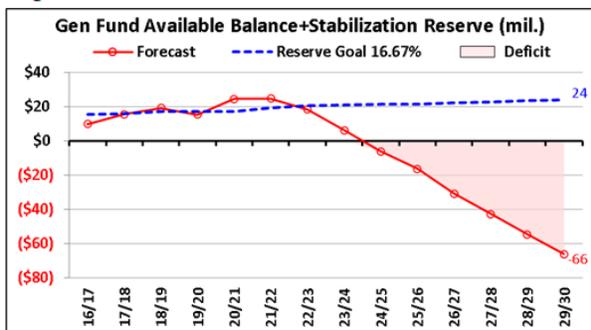
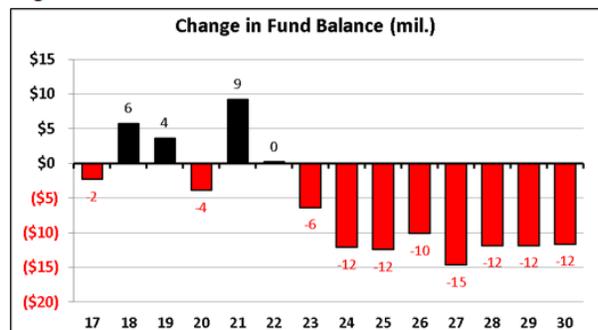


Figure 2



Assumptions as of November 2021:

- Revenue continued to recover at the then current pace and rate.

² Article XIII C of the California Constitution requires that general tax measures be consolidated with a regularly scheduled general election for members of the local governing body, except in cases of emergency declared by a unanimous vote of the governing body.

³ Reserves are designated funds to meet future needs and protect against financial instability. The blue goal line is the target best practice percentage of operating expenditures for the General Fund. This is important to keep in sight as the reserves are needed to protect against unanticipated financial needs such as a pandemic induced recession or large outlays due to a natural disaster. These funds were used to assist the City with COVID-19 impacts and need to be replenished and sustained.

- Modest operating and maintenance costs increase each year.
- With ARPA funding reflected in revenue projections.
- \$5.0M in new expenditure appropriations for homelessness response programs.
- No other new programs or services.
- \$5.5M in new expenditure appropriations for Capital Investment Program (CIP)⁴ and modest growth in expenditures.
- 2.5% inflation

The existing Committee began analyzing the financial status further in order to determine possible next revenue steps. In January 2022, Mayor Brunner continued the Committee and subsequently received approval by the Council in February 2022 to change the Committee to be a Council Ad Hoc Budget and Revenue Committee (2nd Committee) with membership consisting of Mayor Brunner, Vice Mayor Watkins, and Councilmember Brown.

Due to the ongoing financials status of the City, the Committee determined that the sales tax measure should be explored again and directed staff to do a community poll, with some adjustments in questions as needed to align with any condition changes. To gauge the feasibility of increasing sales tax by 0.5 percent, the poll ran in January 2022 and found the following:

- The community considered the top problems in the City to be the impact of homelessness, the need for more affordable and workforce housing and shelters for homeless people, the high cost of housing in Santa Cruz, adequate local future water supply, and the danger of wildfires.
- While support of a sales tax measure was down ~9% from April 2021, the approval estimate of 61% was more than sufficient to support moving forward and especially given the possible impending additional uncertainties of the pandemic, future natural disasters, and inflation.

The 2nd Committee received the poll results as well as the City’s mid-year budget update on February 9, 2022. As of the February projections (Figures 3 and 4), along with a 2.5% FY 2023 budget reduction approach, the City still faces estimated deficits ranging from \$2 million to \$7 million over the next several fiscal years, with no new programs, services, or personnel.

Figure 3

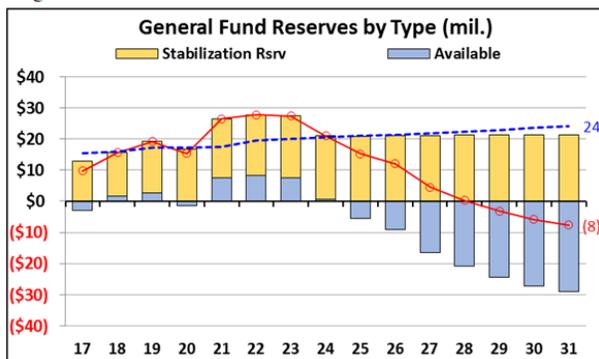
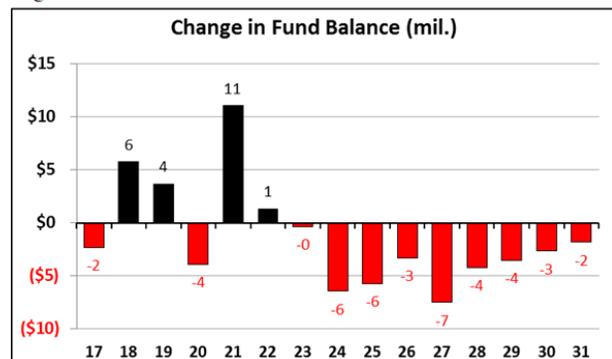


Figure 4



Assumptions as of February 2022:

- Revenue actuals and projections updated.
- Modest operating and maintenance costs increase each year.

⁴ The FY 2022 Budget Book has approximately \$300 million in unfunded CIP projects. See <https://www.cityofsantacruz.com/home/showpublisheddocument/84342/637606472512000000>, pages 11-13.

- With ARPA funding reflected in revenue projections.
- \$4.2M in new, initial expenditure appropriations for homelessness response programs.
- No other new programs or services.
- \$5.0M in new expenditure appropriations for CIP and modest growth in expenditures.
- 2.5% inflation.

With estimated large deficits in near-term fiscal years, and understanding that providing no new programs or services is an unrealistic baseline, funding continues to be critically needed for housing creation, wildfire safety and prevention, expanded or new services for homelessness response, business assistance, mental health crisis response, and capital infrastructure projects. Additionally, the 2nd Committee also balanced, as noted earlier, the possible impending additional uncertainties of the pandemic, future natural disasters, and inflation. They determined that time was of the essence to bring such a significant potential revenue source forward to the community during the June ballot.

DISCUSSION:

2nd Committee Recommendations

Based upon the research, the 2nd Committee determined to pursue a potential transactions and use tax (sales tax) revenue ballot measure for possible inclusion in the June 2022 election.

Sales tax has been a traditional funding source for municipalities. The sales tax is comprised of a 7.25 percent base rate. In addition, the State Revenue and Taxation Code authorizes an additional transaction and use tax that can be added to the base rate up to 2.5 percent for a maximum of 9.75 percent. The City currently receives 1.00 percent of the 7.25 percent base rate and 0.75 percent of additional transaction and use tax for a total of 1.75 percent of the total current tax rate of 9.25 percent.

The combined 9.25 percent sales tax rate in the City of Santa Cruz is equal to or below other cities. Locally, the city of Scotts Valley is at 9.75 percent, with Capitola at 9.00 percent, with Watsonville at 9.25 percent. The unincorporated portions of Santa Cruz County are at 9.00 percent. The proposed increase would put the City at the statutory cap of 9.75 percent. It is also important to consider that the 0.50 percent tax increment between the current 9.25 percent and statutory cap of 9.75 percent could be taken up by other regional tax measures and therefore would no longer be available as a local revenue source for the City. The table below illustrates the different components of the current 9.25 percent sales tax rate.

Jurisdiction	Purpose	Rate
State	Goes to State's General Fund	3.6875%
State	Goes to State's General Fund	0.25%
State	Goes to Local (Non-City) Public Safety Fund to support local criminal justice activities (1993)	0.50%
State	Goes to Local (Non-City) Revenue Fund to support local health and social services programs (1991 Realignment)	0.50%
State	Goes to Local (Non-City) Revenue Fund 2011	1.0625%
County	Goes to county transportation funds	0.25%
City	Goes to City operations	1.00%
Total:	Total Statewide Base Sales and Use Tax Rate	7.25%
Add-on:		

Library	Santa Cruz Library System	0.25%
County-wide	Transportation Funding (Measure D)	0.50%
Metro SC	Santa Cruz Metro Transit District	0.50%
City	Measure H and Measure S	0.75%
Grand Total:		9.25%

As part of the business outreach efforts of the 1st Committee, staff worked with the Committee to develop informational materials about the potential sales tax revenue ballot measure and conducted stakeholder outreach meetings throughout the months of May and June 2021. At the time, feedback from businesses, business groups and hoteliers was largely in alignment with the concerns and needs reflected in the initial public opinion poll results. Businesses raised some concerns about the impact on businesses recovering from the pandemic, but there was also an expressed desire for the City to make progress on addressing the impacts of homelessness and housing affordability in the community. More recent business outreach and feedback following the January 2022 poll has again confirmed that the top issues impacting our business community are in alignment with our polling and continue to focus on the need for affordable and workforce housing and addressing impacts of homelessness in our community. Business outreach is continuing during the week of February 28th and staff will update Council on additional significant feedback at the Council meeting on March 8th.

In order to proceed, the Council must take three actions.

- 1) The first is to adopt a resolution making emergency findings. Article XIII C of the California Constitution requires that general tax measures be consolidated with a regularly scheduled general election for members of the local governing body, except in cases of emergency declared by a unanimous vote of the governing body. The attached resolution has been prepared for City Council consideration and adoption.
- 2) The second action is for the City Council to adopt a resolution ordering a special election and requesting consolidation of such election to place a general purpose one half of one percent sales tax ballot measure. Included in this second action is the proposed ballot measure language and ordinance. This ordinance meets the legal requirements of State law for a local general sales tax to be administered by the California Department of Tax and Fee Administration.
- 3) The final action is to take a position supporting the measure, to authorize the Mayor or provide additional direction regarding the authors of a written argument in support of the measure, and directing the City Attorney to prepare an impartial analysis of the measure and the City Manager to prepare the fiscal analysis.

Proposed Ballot Measure Language

“To protect quality of life in the City of Santa Cruz through programs to support resources to mitigate the impacts of homelessness, create affordable housing, maintain City facilities and essential infrastructure, fix streets, support downtown, maintain parks and recreation facilities for youth and seniors, reduce wildfire risk, fight climate change, and prevent reductions in funding for important city services, shall the City of Santa Cruz be authorized to augment the City’s General Fund by levying one-half of one percent sales tax, raising about \$6 million annually?”

Health in All Policies (HiAP) – This potential ballot measure supports the City’s ability to positively impact Santa Cruz’s integral values of equity, public health, and sustainability (from the City’s Health in All Policies program). Critically important existing services, potential new services, and capital programs can all offer equity, health, and sustainability value to community

members. Examples include: housing for low and very low income levels, as well as workforce housing; homelessness services for care and sheltering; preventative maintenance of natural resources; environmental clean-up and remediation; integrated outreach and assistance across the City and within Downtown specifically; wildfire prevention education and implementation.

FISCAL IMPACT:

Based on the existing trends of the City’s portion of Sales Tax, voter approval of the proposed revenue tax ballot measure would generate approximately \$6 million annually in additional revenue to partially stabilize the City’s General Fund. The cost of the election is estimated to be in the range of \$109,683 to \$182,805 based on figures from the Santa Cruz County Elections Department. This amount may fluctuate, based on the number of registered voters at the time of the election and the number of items the City places on the ballot.

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ATTACHMENTS:

1. Basics of Municipal Revenue
2. CA Local Revenue Measure Results from Nov 2020 Elections
3. Gene Bregman and Associates – City of Santa Cruz 2022 Polling Memo
4. Potential Revenue Measure Fact Sheet
5. Potential Revenue Measure Frequently Asked Questions
6. Resolution of Emergency Findings
7. Resolution to Include a Sales Tax Measure on November 2021 Special Municipal Election, or Aligned with State of California’s Gubernatorial Recall Election