Agenda Report

Fullerton City Council

MEETING DATE: **JULY 17, 2018**

TO: **CITY COUNCIL / SUCCESSOR AGENCY**

SUBMITTED BY: **KENNETH A. DOMER, CITY MANAGER**

PREPARED BY: **KENNETH A. DOMER, CITY MANAGER**

SUBJECT: **CONSIDERATION OF OPTIONS FOR INCREASED REVENUES / EXPENDITURES FOR STREET RECONSTRUCTION / IMPROVEMENT PROJECTS**

SUMMARY

The condition of our streets is consistently an expressed concern by residents and during the budget adoption for the previous Fiscal Year 2017-18 budget, City Staff was requested to explore alternative financing sources for street reconstruction projects. This request has been reported on during Budget Action Item updates and resulted in the presentation explaining the Pavement Management Program (PMP) in December, 2017 and most recently the 2018 updated PMP in May, 2018. Presented for consideration are various options for City Council discussion.

RECOMMENDATION

Provide Staff direction regarding taking any further action(s) on one or more programs to implement revenue measures or increase expenditures for increased street improvement projects.

PRIORITY POLICY STATEMENT

This item matches the following Priority Policy Statement/s:

- Infrastructure and City Assets.

FISCAL IMPACT

Discussion purposes only. Fiscal impact depends on revenue / expenditure option chosen and considered at subsequent City Council meeting.

DISCUSSION

As is well known, the City's arterial and residential streets are in poor condition. The City maintains 67.6 centerline miles of arterials and over 230 miles of local streets. Technically, according to the most recent Pavement Management Program (PMP), the Citywide Pavement Condition Index (PCI) average is 64.7 out of 100, with local (residential) streets at 61.8 and arterials at 69.4. Over 58% of all City streets are in the Fair, Poor or Very Poor condition category, with 27% being in the Very Poor condition category. 106 miles of our local streets need major rehabilitation or reconstruction according to the PMP, representing the highest cost of pavement treatment. The City's current backlog for improvements totals $158 million.

The City receives numerous complaints from residents and non-residents alike on the condition of the roads. At several Council meetings this year, residents used the Public Comment period to voice concern about the street conditions, to include the condition of public alleys which the City's current street program does not address. Additionally, the condition of our streets is consistently a focus during the budget adoption and for the previous Fiscal Year 2017-18 budget, City Staff was requested to explore alternative financing sources for street reconstruction projects. This request was reported on during Budget Action Item updates and resulted in several presentations explaining the Pavement Management Program, street selection process and our funding ability.

Due to ongoing budget constraints, no General Funds are used for street improvements except for one-time only funds such as those generated by City-owned property sales. Therefore, only dedicated transportation funds such as OC GO (formerly OCTA M2 funds), Gas Tax and future SB 1 funds are utilized for street improvements. As has been described in presentations on the PMP, the current amount of transportation funds (approximately $4.8 million a year) are not enough to increase our PCI, let alone maintain the PCI over the next seven years. The City did have an increase in our PCI due to street improvements resulting from the grade separation projects and will see an increase due to the infusion of the property sale proceeds. However, as projected on current funding ability, the PCI will begin to decline again over the next seven years. While the City is projecting expending approximately $4.8 million each year after the current year, if voters overturn SB 1 funding, with the exception of those funds received by November of 2018 and already programmed into projects, the City will lose approximately $2.5 million thereafter, reducing our available revenues to approximately $2.3 annually.

The following are various options for the City Council to consider, discuss and provide direction to City Staff:

Assessment District Formation

One option for increased revenue / expenditures is that the City could work with individually defined neighborhoods to form assessment districts under the Improvement Act of 1911, Municipal Improvement Act of 1913 or other similar acts as allowed by State law. Such assessment districts would work best where the street improvements would be solely beneficial to those paying the assessment versus a situation where other motorists could transit through an area. An example of this is South Pomona Street serving the Meredith Manor development. In this situation, you have a public street with a current Pavement Condition Index of 33 and several public alleys that only serve the immediate residential community. The public responsibility for these alleys is another discussion area and if improvements to them are made it would be recommended to abandon the alleys to make them private alleys, thereby transferring the responsibility of the alleys to the property owner, but transferring them in a “new” state.

In the above example, for both the street and alley reconstruction, the cost would be approximately $420,000 for construction and $80,000 for other items, to include plans, specifications, inspection and contingency.

An assessment district is created by the City but only after obtaining a petition signed by typically 2/3rds of the owners of the properties. A public hearing is held at which time protests are considered. The City would have to advance funds to pay for the required Engineers Report and for most cases, given the lack of funding from the City, to hire bond counsel and a financial team to issue bonds (typically using the Improvement Bond Act of 1915 or other similar instrument) in order to initiate the work. The need for bond funding is because the City does not have the upfront funding to do the work and the property assessments will be paid back over a period lasting up to 15 years. A 15 year payback is recommended since you would not want the payments to outlive the street life. Therefore, the only option is to issue bonds secured by the assessments on each property. The overall process can take 6 to 12 months to complete. A rough calculation using 150 property owners in the area and a 15 year bond is an annual assessment of $425 per owner.

As mentioned above, an assessment district works best where the properties being directly benefited are easily defined. Difficulties would exist to get enough property owner approval and the bond financing and property securitization could hinder participation. Staff burden on this would be high due to the need to work with various neighborhood groups, multiple Engineers Reports and multiple bond financings and continual disclosure requirements. Using an assessment district would be sporadic in its application and could hinder participation by lower income residents / communities due to inability or desire to pay higher annual assessments by either homeowners or apartment property owners (who would simply pass on the cost to tenants).

Gas Tax Bond

Another option for infusing funding into street improvements is utilizing bond funding secured by future gas tax revenues (Gas Tax Bond). Essentially, a city pledges future gas tax receipts as bond payments in order to receive a large, upfront amount to make larger street improvements than they could under normal funding conditions. In Orange County, both Santa Ana and Placentia have issued gas tax bonds. Santa Ana issued $13,145,000 in 2007 and is paying off the bonds over 30 years while Placentia issued $5,955,000 in 2011 and is on a 20 year plan. Placentia pays approximately $480,000 a year in principal and interest for debt service payments, all of which is from their gas tax revenues. Using Placentia as an example, a similar amount would gain the City one year of additional revenue with a 20 year payment plan which reduces overall expenditure ability annually by up to 15% (high range without SB1 funding) for the duration of debt service payments.

The advantage of a gas tax bond is like any bond or lump sum of money: you can get it all at once and make the improvements with greater economies of scale. However, a city must also dedicate a large share of its gas tax as debt service for a very long period of time, generally paying almost twice the amount in principal and interest payments than the lump sum received initially. As such, a gas tax bond is essentially a one-time use of revenue but you suffer a long-term reduction in future road funds. If you have a defined amount of work to be completed and the conditions are right (low prices, low labor costs and low interest rates) such a bond may make sense. Placentia used the California Statewide Communities Development Authority as the issuer. However, a check of their website does not list gas tax bonds as a viable instrument at this time. A gas tax bond is not recommended for the City's street improvement needs.

Dedicated Sales Tax for Transportation or General Sales Tax

Another option for funding street improvements is seeking voter approval for an increase in the sales tax by placing a measure on the ballot. While sales tax measures for general purposes (general tax) currently require a 50% +1 approval, a sales tax that is restricted (special tax) requires a 2/3 voter approval. A sales tax that is dedicated solely for street improvements is a special tax.

In Fullerton, the revenue from our share of sales tax is projected at approximately $21,500,000 for Fiscal Year 2018-19. Using this figure and not accounting for any sales tax loss, a 1 cent increase in the sales tax could generate approximately $21 million while a ½ cent increase would generate approximately $10.5 million.

In Orange County, several cities have gained voter approval for general sales tax increases (Stanton, La Habra, Fountain Valley, Westminster) and it is expected that a few more, potentially Placentia, Santa Ana and Garden Grove, will be seeking a general sales tax increase in November 2018. Typically, a city attempting a general sales tax increase will hire a consultant to conduct a community survey to determine voter sentiment towards the general sales tax proposal in order to determine if such an effort is viable. If determined to be viable, cities also typically hire a consultant to help guide the public education about the general sales tax and to help ensure that such education does not slip into advocacy, which is prohibited by law. Hiring a consultant has been controversial in some communities seeking a general sales tax increase due to the perception of education efforts being advocacy to support passage of the tax. Consultant costs vary, but a rough estimate is $35,000 to $50,000 for the community survey phase and an additional $50,000 for the public education phase. Simply putting a measure on the November, 2018 ballot will cost approximately $18,000. Stand alone or primary election costs are different, and potentially higher.

Potentially hindering any general sales tax effort was a qualified voter initiative supported by the California Business Roundtable (with major support from the American Beverage Association) for the November 2018 General Election to raise approval thresholds from 50% to a 2/3rds majority for general purpose taxes (equaling the threshold now for special taxes). Additionally, this measure would have set an effective date of January 1, 2018, effectively making null and void any general tax passed at the November 2018 General Election unless it obtained more than a 2/3rds voter approval. However, legislators passed and the Governor signed a bill which prohibits any enacted soda tax for the next 12 years and, in return, the ballot initiative was pulled from the November election.

Given the withdrawal of the State initiative, the City could decide between seeking a general purpose sales tax (50% +1 vote requirement) or a special sales tax (2/3rds vote requirement). If the sales tax is general purpose then the City could not restrict nor state that the proceeds are solely for street improvements or it would be considered a special tax. Proceeds from a general tax are discretionary General Fund dollars. However, the City Council could annually program an additional amount equal to the general tax for street improvements, thereby requiring extreme fiscal prudence over other potentially competing issues.

If, since street improvements are a priority, the City Council determined that the residents were to be given the opportunity to decide whether to increase the sales tax dedicated solely to street improvements, the special tax threshold of 2/3rds is required.

If the City Council were to go down either path and let the voters decide on a special tax or general tax, we would need to pass the necessary resolutions and ballot language no later than the August 7^{th} meeting. While the direction to prepare the required documentation and to place the decision on the agenda for August 7^{th} can be by majority vote of the City Council, the City Council would have to vote at that time to put any tax measure on the ballot by 4/5ths vote.

Since a general tax cannot dedicate funds for special purposes, if a measure was placed on the ballot, the proceeds are discretionary and the necessary messaging and safeguards to restrict funding to street purposes would not be undertaken. If the measure was a special tax and dedicated for street improvements, then specific measures to ensure all proceeds are used solely and directly for street improvements would need to be included in the enabling action.

If a special sales tax for street improvements were to be discussed, it would be recommended that it be time limited to no more than 10 years. In discussing the concept with Public Works, our current Pavement Management Program is divided into eight maintenance districts. Based on some of the public comments by residents, many understood the City's financial issues but simply wanted to know when their streets would be improved. The PMP can be greatly enhanced with an additional $10.5 million dollars a year (1/2 cent sales tax) and a program of slurry, overlay, reconstruction and alley improvements could be created to ensure that at least half the City is having some form of street improvement being completed each year. The PMP would be increased from the projected $4.8 million a year to approximately $16 million. As part of the measure, the City Council would be recommended to adopt strict criteria for the use of sales tax funds to ensure it is only used for street improvements (no staff / personnel costs), that all construction contracts are competitively awarded, that the Citizens Infrastructure Review Committee (or similar citizen oversight committee) approve of projects and annual audits the program and that the City report out each year on the improvements funded by the sales tax to show progress on the City's street improvements.

As projected, the additional funds put into street improvements would raise our PCI from its current 64 to a level between 78 and 82. While the significant funding would go a long way to reducing our street improvement backlog, it will not erase it and some streets may not be improved within the ten years. More critical, if SB 1 is repealed in November, that will reduce transportation funding by over $2.5 million a year, further impeding our ability to reduce the backlog. Since such a tax is always a voter discretion, it could be put to the voters to extend it at a future date. However, if it is initially implemented, regardless of extended or not, the street condition will improve with the infusion of funding and the worst of our streets could be improved.

Total Road Improvement Program

Another program through the California Statewide Communities Development Authority is the Total Road Improvement Program (TRIP). This program is only viable if a city has a dedicated local transportation sales tax in place (see above). Like the Gas Tax Bond concept, a city would bond against the local transportation sales tax in order to get a larger upfront amount in which to do major improvements. This program seems better geared towards major projects, such as a grade separation, versus annual road rehabilitation projects and carries the same disadvantages of tying up a funding stream and paying heavy interest costs. Accordingly, even if the City went forward with and gained approval of a special sales tax for transportation, this program would not be recommended for our situation.

Parcel Tax

Along the lines of an increased sales tax, the City could place on the ballot a parcel tax, either for general purposes or special purposes solely for street improvements. The approval requirements are similar as to what was discussed for sale tax measures. A parcel tax is a form of property tax. However, unlike a regular, value-based property tax, a parcel tax is an assessment based on the characteristics of the parcel, such as basing the tax on square footage, by dwelling unit, or a flat rate per parcel. Examples of parcel taxes include funding for schools, libraries, police or fire services, and to a limited degree, for transportation related items.

A parcel tax is one that is purely paid for by property owners and would include all parcels in a city – residential, commercial, and industrial – whereas a sales tax is paid for by those purchasing eligible products within a city and thereby spreading the participation to those that visit, work in, or pass through a city and use the streets in addition to the residents.

Much like a special sales tax, a parcel tax requires a 2/3rds supermajority vote requirement and it can be time limited and have special oversight put in place over the expenditures related to the proceeds.

Status Quo Alternative

The only other option, barring no other action by the City Council, is to keep street improvement funding at its current level. This level of funding will see a peak in our PCI at about 67.7 next fiscal year due to the infusion of one-time only funding from the Meridian property sale, reducing to an overall PCI level of 64 by 2024-25. However, this scenario and PCI level will be significantly reduced if SB 1 is repealed. The City's level of funding will drop by $2.5 million each year in this case and the PCI will approach 60, if not lower during that time frame (assuming no other one-time funds are utilized).