



Agenda Report

Fullerton City Council

MEETING DATE: JULY 7, 2020

TO: CITY COUNCIL

SUBMITTED BY: KENNETH A. DOMER, CITY MANAGER

PREPARED BY: ANTONIA GRAHAM, DEPUTY CITY MANAGER

SUBJECT: BALLOT MEASURE FOR A TRANSACTION AND USE (LOCAL SALES) TAX MEASURE FOR PUBLIC CONSIDERATION AT THE NOVEMBER 3, 2020 GENERAL MUNICIPAL ELECTION AND PREPARATION OF ASSOCIATED DOCUMENTS THERETO

SUMMARY

Consideration of placement of a transaction and use (sales tax) tax measure on the November 2020 General Election ballot. If approved to move forward, City Council must adopt a Resolution to place the proposed sales tax measure on the November 3, 2020 ballot as well as introduce the Ordinance that will be before the voters.

RECOMMENDATION

1. Direct staff to place a ballot measure on the November 3, 2020, General Municipal Election for submission to the qualified voters of a proposed ordinance regarding a general local sales tax measure, a rate approved by City Council and approve actions and other related documents accordingly.

2. Adopt Resolution No. 2020-XX.

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF FULLERTON, CALIFORNIA, SETTING PRIORITIES FOR FILING WRITTEN ARGUMENTS REGARDING A CITY MEASURE AND DIRECTING THE CITY ATTORNEY TO PREPARE AN IMPARTIAL ANALYSIS

3. Adopt Resolution No. 2020-XX.

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF FULLERTON, CALIFORNIA, ORDERING THAT THE CITY OF FULLERTON COMMUNITY SERVICES, STREET REPAIR AND EMERGENCY RESPONSE MEASURE TO ADOPT A ONE AND ONE QUARTER CENT (1.25¢) LOCAL TRANSACTIONS

(SALES) AND USE TAX BE SUBMITTED TO THE VOTERS OF THE CITY AT THE NOVEMBER 3, 2020 GENERAL MUNICIPAL ELECTION

Introduce Ordinance No. XXXX for first reading by title only and waive further reading of the Ordinance.

ORDINANCE NO. XXXX – AN ORDINANCE OF THE CITY COUNCIL OF THE CITY OF FULLERTON, CALIFORNIA, ENACTING A TRANSACTIONS AND USE TAX (SALES TAX) TO BE ADMINISTERED BY THE DEPARTMENT OF TAX AND FEE ADMINISTRATION, SUBJECT TO ADOPTION BY THE ELECTORATE

4. Authorize the City Manager and/or his designee to execute all necessary documents, in a form approved by the City Attorney.

PRIORITY POLICY STATEMENTS

This item matches the following Priority Policy Statements:

- Fiscal and Organizational Stability
- Public Safety
- Infrastructure and City Assets.

FISCAL IMPACT

The County Registrar of Voters office has estimated that the additional cost of adding a ballot measure to the City's consolidated general municipal election would be approximately \$8,500. Funds for the election have been budgeted in the Fiscal Year 2020-21 General Fund budget. Estimated revenues from a 1.25 cent transaction and use tax is approximately \$25 million annually while a 1 cent increase is approximately at \$20 million.

BACKGROUND

The City of Fullerton is a full-service city to include operating its own police department, fire department, and water utility. The City was incorporated in 1904 and is the sixth largest city in Orange County and the 41st largest city in California with a population of approximately 143,000. City services range from providing police and fire services, to senior services, recreational programs for youth and adults, library and children's reading services, support of the Fullerton Museum, municipal water services, storm water and sanitary sewer maintenance, street and sidewalk maintenance, road and street rehabilitation, park, trail and street tree maintenance, street light maintenance, planning and building services, code enforcement, housing assistance, airport operations and general governmental operations.

The City's projected revenue for Fiscal Year 2020-21 is largely derived from property tax (approximately \$47 million to the General Fund) and sales tax (approximately \$21.3 million). Together, these two revenues make up roughly 70% of the overall General Fund revenue to the City. Other revenue sources include transient occupancy taxes (hotel bed tax), franchise fees, charges for services, grants, fine and penalties and use of money (interest).

As the largest revenue source for the City, the City only receives approximately 15.64% of every property tax dollar generated from property owners in the City. The majority of property tax dollars, or approximately 70.72% are provided to K-12 and community colleges as part of the State's funding of education. Accordingly, for an average property tax payment of \$4,000 a year, the City only receives \$625.60 of that payment for City services to include police, fire and public works (street improvements).

Of the sales tax amount, the City only receives 1% of the current 7.75% (or 1 cent for every dollar) for items purchased at physical stores in Fullerton. For items purchased online, which are increasingly becoming more predominant, the sales tax is deposited into a County pool, divided amongst all cities in the County and the City only receives approximately 3% of that purchase's sales tax. An example is on a \$1,000 purchase bought at a store in Fullerton, the current sales tax rate of 7.75% will generate \$77.50 in sales tax revenue and of that amount the City receives only \$10. For an online purchase of the same amount, that \$10, which is the local 1% amount, is deposited into the County Pool and the City will get 3% of it, or 30 cents.

Additional revenue sources that cities can utilize include a Utility User's Tax, which is a tax on the use of utilities such as electricity, gas, and telecommunications. The City of Fullerton does not have a Utility Users Tax. Cities in Orange County with a UUT include: Buena Park, Huntington Beach, Irvine, La Palma, Los Alamitos, Placentia, Santa Ana, Seal Beach, Stanton, and Westminster. Many cities utilize a Transient Occupancy Tax (TOT), or hotel bed tax. The City has a TOT for overnight motel / hotel stays at a rate of 10% of the cost of the stay. This amount generates approximately \$3.1 million a year based on the amount and type of hotels within the City, but it is also greatly impacted by the reduced travel due to the COVID-19 health pandemic. In contrast, the City of Anaheim generated approximately \$165 million in TOT prior to the COVID-19 pandemic.

Additionally, growth patterns affect how a city produces revenues. Prior to the passage of Proposition 13, a city would set their expenditure budget, and then set the property tax rate locally to generate the necessary revenue required to meet the expenditures that were not met with other revenues sources. Proposition 13 in 1978 dramatically changed that, setting property taxes at 1% of a base line assessed valuation of the property. Assessed values are allowed a 2% growth per year unless a property, typically residential, changed ownership upon which the assessed value was reset to the market value upon which the property was transacted. This is the reason that neighbors in Fullerton can be paying drastically different property tax amounts. A long-term resident who owned a property prior to Proposition 13 pays a fraction of the property tax of a neighbor who only recently purchased their house due to their difference in assessed values.

Accordingly, the City is highly dependent on Property Tax and Sales Tax revenues for annual operations and City service levels. Property Tax is a stable revenue source with limited opportunity to increase its year over year generation, however, it has been diverted in the past by the State. Sale Tax, as currently allocated at the 1% amount, fluctuates based on economic activity and is limited by the amount of commercial / retail activity and land use allowance in the City. As cities are planned, they are carved into different land uses to include residential, commercial, industrial, office, open space, etc. The City of Fullerton developed with a higher percentage of residential land use to provide housing opportunities for the larger industrial / manufacturing areas that were major employers

post World War II, to include the Hughes Aircraft campus on 350 acres in what is now Amerige Heights, currently a largely residential area.

Accordingly, Fullerton's commercial land use is approximately 4.7% of total land in the City. As a comparison, the City of Orange's commercial land use is approximately 6.5%. Both cities are approximately the same geographical size and with very near the same populations. However, the City of Orange generates approximately \$45 million in sales tax compared to Fullerton's \$21.3 million. While Orange has more automotive sales, the difference in commercial land use also plays a major role in the increased revenue from sales tax. While increased economic development is critical to a City, a renewed emphasis will not create substantial revenue opportunities overnight. And rezoning land from one use to another, under current planning law, is difficult specifically with the need and emphasis for more housing. First floor retail under higher density housing will not create the revenue needed for current City infrastructure and operational needs let alone for the increased demand in services from the residents who would populate such housing.

Over the last three years, the City has managed to obtain a balanced budget largely through reductions in services, concessions from employees, and re-organizing departments more efficiently for more effective service delivery. The City has conducted organizational reviews of the Public Works Department, Community Development Department, City Clerk's Office and is currently reviewing the Parks and Recreation Department and the Administrative Services / Human Resources Departments.

Additionally, the City has contracted out street sweeping, jail operations and was going to contract out half of our landscape services until the COVID-19 pandemic and the significant reduction in revenues attributable to the health crisis. At this time, as approved in the Fiscal Year 2020-21 budget, the City will maintain half the landscaping services and reduce its ability to maintain parks, medians, City Hall and trails to a lower level of service because we cannot afford restoring services or paying for a contractor.

As part of the Fiscal Year 2020-21 budget, as discussed at the June 2, 2020 Council meeting, the City is projecting a \$7.9 million General fund operating deficit, mostly from the fiscal impacts of COVID-19. To exit the previous Fiscal Year, the City will use about 30% of its reserves. As part of the budget balancing options Staff obtained Council approval for the following: Maintaining positions vacant, specifically in the Police Department (seven sworn positions), and 68 full-time positions across other departments, for increased vacancy savings; Temporary Closure of the Museum and eventual re-organization to bolster the non-profit Museum Association and reduce \$500,000 in General Fund subsidy; Reducing the Library's hours open to the public from 61 to 34 Hours; Executive Team, including the City Manager, for salary reductions of 10%; and, direction to obtain reductions from employee associations. As an ongoing effort, Staff will continue to review all Citywide Professional Services & Contracts as well as slashing training and travel due to more online opportunities.

In an effort to address the City's fiscal position, City departments have continually cut their operational budgets and in an attempt to simply do more with less. The short term resolution of doing more with less does not support sustainability of long term programs and service levels. Given the City's challenging financial position, most of the reductions

in staffing that were made following the Great Recession were never refilled which has continued to impact level of service provided even as departments have implemented a number of efficiency enhancements, to include a greater use of technology.

Overall, local revenues have not kept pace with the rising costs of maintaining city services and the City has identified serious and significant future fiscal threats, including:

- COVID-19 Impacts to our local businesses and ultimately to City revenues
- Ability to maintain the current level of services to the community
- The growing need to address homelessness in our community
- Lack of funding for street, road, and sidewalk repair
- Significant growth in projected unfunded accrued liability (UAL) pension costs due to investment underperformance by the State-run CalPERS retirement system
- The pace of inflationary service (e.g. labor and operational cost increases)
- Inability to fully achieve fund adequate reserve levels (17% versus 10%)
- Projected subsidies to the Brea Dam Fund and Museum
- Infrastructure and citywide technology needs
- Employee retention and attraction challenges resulting from a lack of parity in salary schedules with other cities, counties, districts.

Recognizing infrastructure improvements, specifically streets, as a priority item from the community, on April 23, 2019 City Council directed the Infrastructure and Natural Resources Advisory Committee (INRAC) to study the City's current infrastructure conditions and future needs and make recommendations regarding funding needs to address them. The INRAC Committee returned to City Council in March 2020 with a report stating additional revenues through a locally-controlled revenue stream are necessary to address the most critical infrastructure needs for our community and to invest in the City's future through forward thinking and thorough planning. This most recent report mirrors the findings of several similar reports dating back to the 1980's which all showed a need to invest more in the City's infrastructure but a general inability to finance such investment.

Prior to INRAC studying the state of the City's infrastructure, on April 23, 2019 a Strategic Planning Study Session was held with City Council. At this meeting staff presented the results of a Community Stakeholder Engagement survey that had been posted online to solicit public input related to the Strategic Planning Process. 715 responses were received and written statements submitted via email. Based on the results, there was a desire for City Council to further understand community perceptions and needs. Staff was directed to perform a formal Community Survey. Staff solicited formal Request for Proposals from qualified firms to conduct professional public opinion polling services. The City received six proposals and subsequently awarded a contract to FM3. The results of the survey indicated that respondents have mixed opinions about the City: they mostly consider it a good place to live and a safe community. But there is concern about the direction of the City and increased crime. Based on the responses, there was a strong sense that the City needs additional funding to address key priorities such as:

homelessness, condition of streets and infrastructure, and emergency response/public safety.

As part of the survey, FM3 asked about respondents attitudes on revenue opportunities available to cities. The City does not have any additional or add-on revenue enhancements. At that time, FM3 found that six-in-ten respondents supported a potential sales tax measure. While this polling was prior to COVID-19, FM3 conducted a tracking poll to include some questions related to current events, and a sales tax measure as proposed is still viable.

At the March 3, 2020 City Council meeting, INRAC presented their recommendations to the Council as to how the City could fund citywide infrastructure improvements. Their conclusion was that the City should move forward with a dedicated (special) sales tax measure for infrastructure improvements that should generate over \$25 million per year to be used exclusively on infrastructure. However, as indicated in the polling data it is unlikely that a special tax, which requires a 66.7% voter approval, would pass. Based on the overall need to make the City financial sustainable, and make great improvements to the City's infrastructure, address homelessness, resident's public safety concerns and general operational items, Staff continues to recommend a general tax be placed on the ballot.

DISCUSSION

Based on decades of decisions, the City continues to experience severe challenges to maintaining a balance of General Fund expenditures with ongoing revenues. This challenge exists all the while still providing high levels of service to our residents and community. Some of the fiscal issues that face the City include: slow revenue growth, limited sources of revenue, increasing pension costs and the need to support critical infrastructure and capital improvement projects to include reversing decades of street deterioration.

What is a Transaction and Use Tax (Local Sales Tax)?

Sales tax is imposed on retail transactions for tangible personal property. The *Use tax* is imposed on consumers of tangible personal property that is used, consumed or stored. Sales tax is not applicable to several general categories including:

1. Necessities of life (food products, health related, housing)
2. General public benefit (alternate energy, museums, public art exhibits)
3. Industry benefit (transportation related such a motor vehicle fuel, entertainment industry)
4. Exclusion by definition (admission charges, sales price/gross receipts)
5. Other exemptions.

Under California law, transaction and use taxes may be approved locally and added to the combined state, county and local sales and use tax rate as long as the total rate does not exceed the state-set cap of 10.25%. The current sales tax rate in Fullerton is 7.75%, and up to a 1.5% local transaction and use tax could be implemented.

By law, all of the money generated by this measure can only be used in Fullerton. It will also include tough accountability provisions such as annual independent financial audits to ensure funds are used as promised for programs and services that benefit Fullerton residents.

A city may levy, increase or extend a transactions and use tax for general purposes if the ordinance proposing that tax is approved by a *two-thirds vote* of City Council (four of five councilmembers) followed by approval of a majority vote of the qualified voters of the city"¹. Attorneys specializing in state and local taxes recommend that City Council follow the standard procedure for adopting ordinances, i.e., give first and second reading, in order to comply with the "approval" requirement in Revenue and Taxation Code Section 7285.9. The attached Ordinance is prepared in accordance with the Revenue and Taxation Code's requirements for a transaction and use tax and has been reviewed and approved by the California Department of Tax and Fee Administration ("CDTFA") prior to its presentation to City Council.

It is important to note that City Council is not deciding whether to impose the tax. Rather, City Council's role in this process is in deciding whether to place the matter on the ballot for consideration by the voters of Fullerton.

A general purpose tax measure, such as the measure recommended by Staff, requires approval from only the majority of votes (50% plus 1) to implement. Sales and use tax is a commonly used method by various cities to generate additional revenue for city programs and services.

The following Orange County cities have a local sales and use tax measures.

City	Increment	Year	Sales & Use Tax Rate
Fountain Valley	1.0%	2016	8.75%
Garden Grove	1.0%	2018	8.75%
La Habra	0.5%	2008	8.25%
La Palma	1.0%	2016	8.75%
Placentia	1.0%	2018	8.75%
Santa Ana	1.5%	2018	9.25%
Seal Beach	1.0%	2018	8.75%
Stanton	1.0%	2014	8.75%
Westminster	1.0%	2016	8.75%

Programs and Services the New Revenue will Fund

If approved by the voters, the revenue generated would help fund not only the needed improvement to the City's infrastructure, but also support the City's homeless initiatives, community services and public safety / emergency medical needs. The City of Fullerton is responsible for maintaining over 295 linear miles of streets and roads and repairs are needed on over 70% of streets within the City. The City's unfunded / deferred street repair liability has grown to approximately \$150 million and is projected to grow to \$180 million by 2026 if additional funding is not dedicated each year to address street conditions.

¹ Revenue and Taxation Code Section 7285.9

Beyond streets, City infrastructure (funded by the General Fund) includes alleys, bridges, public buildings, trees and landscaping, parking lots, parking structures, parks and trails, traffic signals, streetlights, vehicles and equipment. Similar to streets, all of these assets require regular maintenance, repair and replacement and without additional funds, will continue to decline.

Public safety continues to be a priority in the City of Fullerton and represents over 70% of the City's General Fund. Without a continued local funding source, the City will be forced to cut gang and drug prevention services, not be able to increase proactive Community Policing and reduce the successful Homeless Liaison Officer program. Additional funding will help the City to initiate and improve prevention and community programs.

In addition to the City's infrastructure and safety needs, a top priority as identified in the polling is homelessness. The City and 12 other North Orange County Cities are part of the North Service Planning Area (SPA) and are collaborating on opening two partnership Navigation Centers to assist homeless individuals and families in the North Orange County area. The funding source for these programs are State funds which fluctuate and do not cover the entire need. In addition to contributing financially to the shelters the City hosts the Fullerton Armory which serves as a shelter during the cold weather months and a privately run shelter / recuperative care center. Additionally as part of the North Orange County Public Safety Task Force, the City receives funding to support outreach through our provider City Net. This \$155,000 annually is set to cease in June 2021 and there is no replacement funding source.

In order to more proactively assist the Fullerton homeless population City Staff propose to hire an internal Case Management Team focused solely on Fullerton and to increase clean-up of encampment sites.

Transparency and Accountability

If a local sales tax measure is approved by the voters in November 2020, City Council shall appoint residents to a Citizen Oversight Committee. This committee would provide citizen oversight in collaboration with the City's Administrative Services Department to ensure fiscal accountability, transparency and to verify that sales tax funds are being used as appropriately to meet residents' priorities. A report will also be made to the INRAC so that the City's infrastructure needs are continually addressed by the new funding.

Public Education and Outreach

Based on the discussion that ensued at the March 3, 2020 City Council Meeting, specifically during the recommendations presented by INRAC and options presented by Staff, it was requested that the City bring back for future City Council consideration the potential of utilizing a public education firm to assist the City to communicate its needs if a sales tax measure were to be placed on the ballot as well as to ensure that all efforts were indeed educational and not advocating for any proposed measure. If a sales tax measure is approved to be placed on the ballot, City Council will be asked to consider the award of a contract through a separate Regular Calendar agenda item.

Conclusion

Currently, the City's FY 2020-21 General Fund budget has a \$7.9 million deficit which will be closed by through hiring freezes, additional operational reductions, reductions in part-time staffing levels and to be negotiated salary and benefit reductions.

While the City's policy is to strive to achieve a minimum 17% recommended Fund Balance Reserve (contingency reserve), the City ended FY 2018-19 with a \$9.5 million or a 10% contingency reserve. The General Fund is projected to end FY 2019-20 with a \$3.2 million General Fund deficit which will be offset through the use of City Council approved contingency reserves. This use of contingency reserves compounded with the fiscal impacts of COVID-19 will further deplete remaining contingency reserves the City will need to weather future unforeseen negative fiscal impacts. Without revenue enhancements, the City will require service level reductions to restore contingency reserve balances.

In the event the local sales tax measure is not placed on the ballot or if it ultimately fails to gain voter approval in November, the City will continue to operate as efficiently and effectively as possible, but we will be forced to begin to make very difficult decisions regarding service levels and operations of programs in order to achieve balanced budgets over the succeeding years.

Attachments:

- Attachment 1 – Draft Resolution No. 2020-XX and Draft Ordinance XXXX
- Attachment 2 – Draft Resolution No. 2020-XX