

To: Honorable Mayor and Members of the City Council

From: Elizabeth D. Warmerdam, Acting City Manager

Re: Discussion of Potential Revenue Measures (City Manager 2110)

BACKGROUND

While the City of Alameda has a history of taking proactive measures aimed at fiscal discipline and is currently meeting its policy of a 25% reserve, significant financial challenges exist, including a projected General Fund deficit in five years due to CalPERS increasing payments towards the City's unfunded liabilities and substantial deferred infrastructure and public facility needs. In the City Council's [February 20, 2018 consideration of an infrastructure bond](#), nearly \$300 million in infrastructure needs were identified that are beyond the City's current and projected funding capacity. The City Council's [March 20, 2018 midyear budget update](#) detailed how long-term PERS unfunded obligations are projected to result in an annual \$6 million funding gap by FY 2021/2022.

Funding gaps require difficult choices including reduction in service levels or increasing revenues. These challenges are not new. The City of Alameda has been considering them since at least 2009, with the Fiscal Sustainability Committee's *Long Range Financial Forecast 2009-2019* and the last two biennial budget processes.

Since 2000, Alameda has had four local revenue measures on the ballot. Over that same time period, the cities of Berkeley (19), Oakland (14), and San Leandro (7) had more measures. Alameda's four revenue measures were:

- In 2000, Measure O (78% of voters approving) was an \$11 million general obligation bond to fund the new Main Library and improvements to branch libraries;
- In 2008, Measure P (51% of voters approving) raised the property transfer tax from \$5.40 to \$12.00 per \$1,000 of value, resulting in a significant benefit to the fiscal stability of the City;
- In 2012, Measure C (51% of voters approving) failed as it was short of the two-thirds threshold required whenever revenue is dedicated to specific projects; with this measure, funds were proposed to be dedicated to city vehicles, library improvements, and constructing an emergency operations center; and
- In 2016, Measure K1, the Utility Modernization Act (73% of voters approving) modernized the existing Utilities Users Tax and confirmed Alameda Municipal Power's (AMP) historical support of city services.

Recently, Alamedans have shown a willingness to raise local funds to meet local needs. In a summer 2017 community survey, Alamedans showed support for a cannabis business tax (65% in favor), ½ cent sales tax increase (64% in favor), and a \$95 million infrastructure bond (75% in favor). A February 2018 tracking survey, focused solely on the infrastructure bond, found Alamedans' approval at 70-73%.

For a revenue measure to be placed on the November 2018 ballot, the City Council would have to take official action no later than the its July meetings.

There are three options for revenue measures that may be appropriate for this fall:

- 1) *Cannabis business tax*, which was first considered in a [November 2016](#) City Council referral and referenced most recently in an item heard on [March 6, 2018](#);
- 2) *Infrastructure bond*, also known as an ad valorem property tax or general obligation bond, which was considered on [February 20, 2018](#);
- 3) *Sales tax*, which was explored on [June 7, 2016](#), along with placement of the Utility Modernization Act, for the November 2016 ballot;

A summary comparing the key aspects of each measure is provided in the table below.

Table 1: The Basics	Cannabis Tax	Infrastructure Bond	Sales Tax
Estimated annual revenue	\$260,000- \$770,000	\$6 million	\$4.9 million
Vote to place on ballot	3 of 5 Council members	4 of 5 Council members	3 of 5 Council members
Voter threshold	50%+1 for general purpose	67%	50%+1 for general purpose
Who pays?	Cannabis manufacturers, testing labs, dispensaries, and plant nursery	Property owners	Consumers of products
What is proposed tax rate?	4% gross receipts (excise) tax	\$23/\$100,000 of assessed value	½ cent per \$1 spent
Time tax collected	In perpetuity, unless City Council adjusts	Through bond repayment, 36 years	In perpetuity, unless City Council adjusts
Where do funds go?	General Fund (or special fund)	Bond Fund	General Fund (or special fund)
Funds restricted?	No, unless special purpose	Yes, to capital improvements	No, unless special purpose
Budgets impacted	Operating and/or capital	Capital	Operating and/or capital

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DISCUSSION

While staff intends to recommend that the City Council at its June 5, 2018 regularly scheduled meeting provide direction on potential revenue measures for the upcoming November 2018 ballot, the May 18 workshop also provides an additional opportunity for the City Council and community to provide feedback regarding potential revenue measures as part of the mid-cycle budget review and discussion. While the cannabis tax and infrastructure bond are both worthwhile measures, the ½ cent sales tax measure benefits both the City's forecasted operating deficits and capital needs, and its placement in November 2018 is one of a limited number of elections during which the City has the state's permission to submit the issue to voters and to do so during a favorable economy.

If City Council directs a measure to be placed on the ballot, introduction of the related ordinance (if required) could occur no later than July 10, and final adoption of either the ordinance and/or resolution must occur on July 24. These are firm deadlines as any measure must be submitted to Alameda County Registrar of Voters in early August for the November 2018 ballot.

There are pros and cons to advancing any one of these measures, or to choosing to advance no measure at all at this time. Staff recommends that, if any measure is put on the ballot this fall, it is only one measure. Advice from experts in this field suggest that voters fatigue when two local revenue measures are on the same ballot, leading to both measures having reduced rates of success.

Voters' appetite for a revenue measure increases during the positive part of an economic cycle, and decreases during the negative part of an economic cycle. The United States (and California) is in the midst of one of the longest economic expansions in its history, yet this positive part of the economic cycle cannot continue forever. If a revenue measure is part of the solution to Alameda's financial challenges, then the economic cycle suggests placement on the ballot sooner rather than later.

All three tax options were part of the [community survey in summer 2017](#). The [February tracking survey \(at Exhibit 2\)](#) only included the infrastructure bond. If the City Council chooses to place a revenue measure on the fall ballot, it may or may not desire further polling/communications support. If the City Council considers revenue measures as part of a longer term financial strategy to develop solutions to the City's capital and operating needs, staff suggests budgeting up to \$55,000 per year to conduct annual polling and/or communications support.

Table 2 summarizes the pros and cons of the four revenue measure options. Following the table is a discussion of each option and, if City Council wishes to pursue the option, further direction sought by City staff.

Table 2: Options	Pros	Cons
#1 Do not place a measure at this time	<ul style="list-style-type: none"> • No cost • Limits tax or fee increases • Provides more time to consider a future measure 	<ul style="list-style-type: none"> • Continues funding gaps • Delays long-term solutions to structural deficits • Postponement creates risk of less favorable economic market
#2 Place cannabis tax	<ul style="list-style-type: none"> • Likely to succeed (65% support) • Puts tax in place prior to existence of operating businesses (except testing labs) 	<ul style="list-style-type: none"> • Uncertainty from preemption and Taxpayer Fairness proposition (more below) • Significantly less revenue generated than other measures, and if tax is set lower than 4%, revenue will be lower
#3 Place infrastructure bond	<ul style="list-style-type: none"> • Addresses significant capital needs • Extensive public outreach already complete • Surveys suggest viability (70-73% support) 	<ul style="list-style-type: none"> • Difficult 2/3 voter threshold • No guarantee for any specific project • Does not address operating deficit • Does not fully fund infrastructure needs
#4 Place ½ cent sales tax	<ul style="list-style-type: none"> • Addresses significant need and operating deficits • Likely to succeed (64% support) • Visitors to Alameda contribute 	<ul style="list-style-type: none"> • No guarantee for any specific program or project • Uncertainty from Taxpayer Fairness proposition (more below) • Raises cost to consumers

Option #1: No Measure. If no measure is placed on this November’s ballot, the City Council may consider providing direction to staff to research revenue measures for 2019, 2020, or beyond as part of the City’s long term financial strategy. Staff’s current work plan includes returning to City Council for permission to initiate a mail-in ballot for a stormwater fee in calendar year 2019. Besides the revenue measures described above, there are other revenue measures that may or may not fit into the City’s long term financial strategy. These include:

- **Business License Tax:** enacted in 1943 with outdated language, this tax is adjusted annually, where applicable, by the Consumer Price Index. It is charged to local businesses and raises \$2.2 million annually for the General Fund.

- Transient Occupancy Tax (TOT): enacted in 1974, this tax has not been adjusted since 1990. The hotel occupant pays the tax, which is equal to 10% of the rent charged by the hotel. It raises \$2.1 million annually for the General Fund. TOT in surrounding jurisdictions ranges from 12% to 14%, therefore, there is room to increase the tax and remain competitive. A 1% to 2% increase in TOT would raise an additional \$150,000-\$300,000 annually.
- A “Soda Tax” is a one cent tax per ounce tax on sweetened beverages. Albany (70% support), Berkeley, Oakland (60% support), and San Francisco (61% support) passed these taxes in recent years. Annual revenue varies between Albany (\$230,000 per year); Berkeley (\$2.5 million per year), Oakland (\$11 million per year), and San Francisco (\$15 million per year).

Option #2: Cannabis Tax. If the City decides to tax any, or all, cannabis business types, it would be levying a gross receipts tax, or gross excise tax, which is a tax on the total gross revenues of a company, regardless of their source. A gross receipts tax is similar to a sales tax, but it is levied on the seller of goods or services. The State also imposes a 15% excise tax on all cannabis businesses. AB 3157 proposes to reduce the State tax from 15% to 11% for the next three years to allow the industry to stabilize. State and local excise taxes are in addition to sales tax that is charged to buyers of adult use cannabis products (medicinal cannabis is exempt from sales tax).

Should the City Council decide to place a cannabis tax on the November 2018 ballot, this will also require deciding:

- *Whom to tax?* The City could choose to tax a combination of: manufacturers, testing labs, dispensaries, plant nurseries, or distributors, or all of the above. Some jurisdictions exempt testing labs from a cannabis business tax arguing that the laboratories are not a cannabis business but rather provide a service to those in the cannabis industry much like attorneys, graphic designers, marketing consultants, etc. Other jurisdictions do not tax, or impose a reduced tax on, medicinal retailers pointing out that if cannabis products are being used as medicine they should not be taxed or should be taxed at a reduced rate. If all business types are taxed at 4% of gross receipts, the annual estimated tax revenue is \$600,000, with the low end assumption of \$367,000 and the high end assumption of \$1.18 million.
- *What is the appropriate tax rate?* If the tax is too high, it will discourage legal purchase of cannabis in a particular city (versus nearby cities with lower taxes) and/or encourage the underground market sale of the product, where no tax whatsoever is collected. For these reasons, the City of Berkeley recently lowered its cannabis tax from 10% to 5% (and 2.5% for medicinal). Oakland’s tax is 10% for adult use retailers (5% for medicinal), distribution, and cultivation; and 3-5% for manufacturing, testing, and R&D. San Leandro’s tax is 6% for all permitted business types. SCI, the City’s cannabis tax consultant, recommends a 4% tax on all business types except for testing labs, which it suggests should be exempt from the tax. A 4% tax that excludes testing labs would generate from a low of \$294,000 to a high of \$848,000 annually.

- *Should this tax apply to both medicinal and/or adult use/recreational cannabis?* While SCI recommends a 4% tax on adult use retailers, it recommends a reduced tax (or no tax) on medicinal cannabis retailers. Alameda currently permits medicinal retailers only (no adult use). Therefore, if a cannabis business tax was put to the voters in November 2018, a tax on adult use retailers, in anticipation of adult use retailer being permitted in the future, should be considered. Consideration of a reduced tax, or no tax, on medicinal cannabis retailers may also be appropriate. A 4% tax that excluded medicinal cannabis retailers only would generate from a low of \$335,000 to a high of \$1.1 million annually. A 4% tax that excluded testing labs and medicinal cannabis retailers would generate from a low of \$260,000 to a high of \$770,000 annually, which is the range reflected in the table above.
- *Potential discussion Topics:* if a cannabis business tax is placed, should the tax be set at 4%, applied to all cannabis businesses except testing labs, exclude medicinal cannabis, and establish a tax for adult use sales in the event such businesses are permitted in the future?

Option #3: Infrastructure Bond. Should the City Council choose to place the infrastructure bond on the November ballot, City staff would seek further direction on the following:

- *Amount.* What is the appropriate amount for an infrastructure bond? Staff's previous analysis and polling evaluated the potential of a \$95 million infrastructure bond, as reflected in the table above.
- *Alameda Point.* Should the bond include the replacement of the drinking water infrastructure at Alameda Point as an eligible use of bond funds? If yes, then should the bond only permit, or require, developer fee reimbursement for that expense? If the bond includes drinking water infrastructure at Alameda Point, should the bond include language reconciled with Alameda Point's fiscal neutrality policy?
- *Specificity.* Should the bond expenditures be more specific by showing percentages on the categories of infrastructure expenses? Would more specificity include a draft list of proposed projects for the first phase of \$30-\$35 million in infrastructure funding?
- *Guidelines.* Should the City Council adopt guidelines for eligible projects in advance of the measure's vote? Examples of draft guidelines are as follows:
 - i. Focus on deteriorating facilities and infrastructure;
 - ii. Provide community-wide benefits;
 - iii. Advance goals from the City's adopted plans such as: transportation, climate/sea-level change, disaster/emergency response and preparedness, etc.;
 - iv. Help the City become more environmentally responsible, resilient, and financially sustainable, including lowering or containing future costs to local taxpayers; or

- v. Leverage taxpayer dollars to secure additional matching grants or other funding that may otherwise go to other communities.

Option #4: ½ cent Sales Tax. [AB 366](#), with the assistance of Assembly member Bonta, adopted by the California legislature and signed by the Governor in 2016, authorizes the City of Alameda to submit to its voters in any general election before January 1, 2025, a request to raise its sales tax by ½ cent. This legislature's permission is required due to California's Revenue and Taxation Code section 7251.1, which restricts local sales tax increases. Alameda can only place a sales tax measure in general elections, which are held in November of even numbered years: 2018, 2020, 2022, and 2024. After January 1, 2025, Alameda voters will not be able to consider a general sales tax measure unless the California legislature and governor approve a new bill permitting it.

Other Considerations for Potential Revenue Measures

- *Tax Fairness, Transparency, and Accountability Act of 2019.* An initiative that may qualify for placement on the November 2018 statewide ballot will, if also approved by California voters, require a two-thirds vote of a city's electorate to approve any changes to local taxes. Each of the three measures may be subject to the initiative, and this initiative would apply not only to future measures, but also measures on the November 2018 ballot. Thus, if the cannabis or sales tax were placed on the November 2018 ballot and garnered 50-65% support, each may still fail if the Tax Fairness initiative passed in the same election. Given the infrastructure bond threshold is already two-thirds, this initiative would not affect this option.
- *Why not consider other special tax measures, such as a parcel tax, or sales tax dedicated to specific projects?* Both a parcel tax or a sales tax dedicated to specific projects are considered *special* taxes that require 2/3 of voters to approve them. Since 2002, fewer than half of these measures passed statewide. By comparison, a general tax, which includes the ½ cent sales or cannabis tax considered above, has succeeded 75% of the time statewide. Infrastructure (or general obligation) bonds have succeeded 55% of the time statewide. Given the improved likelihood of success of the general sales or cannabis tax and, to a lesser extent, the infrastructure bond, staff did not consider special taxes further.
- *City's labor contracts and the Balanced Revenue Index (BRI).* This item requires additional research. However, the labor contracts that reference the BRI refer to the Bradley Burns Sales and Use Tax. The ½ percent sales tax for consideration is a Transaction and Use Tax ("add-on sales tax") and is potentially not factored into the city's BRI. Whether the BRI itself continues in future memorandum of understandings (MOUs) with the City's bargaining units is a subject of negotiation. MCEA and ACEA's current MOUs expire December 31, 2018, and public safety's MOUs expire in 2021.

- Why not a potential tax measure for our stormwater needs? As discussed in budgets for [2015-2017](#) [page 14] and [2017-2019](#) [pages 22-24], Alameda has had a stormwater fee since the early 1990s that is failing to keep up with the significant operations and capital requirements of the stormwater system. The fee has remained flat for more than a decade. Due to legal uncertainties related to Proposition 218, no cities in the last 15 years have adjusted an existing stormwater fee. Thus, Alameda's fee remains approximately \$50 per single family home, and the stormwater fund will run a deficit and may run out of money as early as FY 2020. At the same time, mandates of the State Regional Water Quality Control Board are requiring an even greater investment in new stormwater infrastructure. If the stormwater fee is not adjusted in one way or another, these needs will have to be addressed by the General Fund or, where appropriate, other funds.

However, the stormwater fee is not suitable for the November 2018 ballot because it would require a fee study that is not scheduled to be completed until the end of this calendar year, changes to our municipal code, and it would require 2/3rd voter approval to succeed if put on the November ballot. Due to elections law, the same ballot *mailed* to Alameda property owners would require only a 50%+ 1 threshold to succeed. This is the process three cities recently followed in proposing a new stormwater fee: [City of Palo Alto](#) (April 2017), [City of Berkeley](#) (in process), and [City of Moraga](#) (in process). Palo Alto's mail-in ballot measure (average annual fee of \$163 per single family home) was approved with 65% of the vote. The results of Berkeley's (average annual fee of \$43 per single family home) and Moraga's mail-in ballots (annual fee of \$68-\$150 per single family home) will not be known until late May.

The process followed by the cities of Palo Alto, Berkeley, and Moraga is not the one described in a new state law, [SB 231](#). It passed the state legislature and was approved by the Governor in October 2017. SB 231 authorizes a process for adopting or adjusting stormwater fees much like the process for sewer fees. However, no cities have utilized SB 231 to date, as it is almost certain to face litigation that will take years to resolve and require hefty legal fees, and is therefore not recommended for Alameda right now.

Given this context, staff proposes to return to City Council to gain its permission to initiate a potential mail-in ballot for a stormwater fee in calendar year 2019.

Next Steps

The following provides a potential schedule, if direction is provided at the June 5, 2018 City Council meeting to pursue a revenue measure for the November 2018 ballot:

- June 5, 2018 - Recommend City Council provide direction on a potential revenue measure for November 2018 ballot.
- July 10, 2018 - Deadline for approval of infrastructure bond placement.

- July 24, 2018 - Deadline for approval of cannabis or sales tax placement.
- August 2018 - Deadline for submittal of measure to County Registrar of Voters.
- November 6, 2018 – General election.

As described above, there will be potential for placement of revenue measures at future elections and ballots, including a potential mail-in stormwater ballot in 2019, and at general elections in 2020 and 2022 or special elections. Additionally, potential revenue measures can continue to be considered as part of subsequent budget cycles, such as the upcoming 2019-2021 budget adoption.

FINANCIAL IMPACTS

Since the City is already holding an election in November, placing one revenue measure on the November 2018 ballot is likely to cost in the range of \$10,000 to \$25,000 for printing and translation. Not placing a revenue measure on the ballot means that the City's long-term financial challenges will remain without a solution, and in the case of public infrastructure, the costs of future repairs will continue to increase. Should City Council request additional polling or communications support in advance of placing a measure on the ballot this fall, there would be additional consultant costs related to this work.

MUNICIPAL CODE/POLICY DOCUMENT CROSS REFERENCE

None.

ENVIRONMENTAL REVIEW

This activity is not a project and is exempt from the California Environmental Quality Act (CEQA) pursuant to section 15378 (b)(4) of the CEQA Guidelines, because it involves governmental fiscal activities (approving funding mechanisms), which does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment.

RECOMMENDATION

Discuss potential revenue Measures.

Respectfully submitted,
Liam Garland, Public Works Director
Debbie Potter, Community Development Director
Edwin Gato, Acting Finance Director

Financial Impact section reviewed,
Edwin Gato, Acting Finance Director