



STAFF REPORT

DATE: JUNE 13, 2018
 TO: HONORABLE MAYOR AND CITY COUNCIL MEMBERS
 FROM: BILL SMITH, CITY MANAGER
 PREPARED BY: STACEY DABBS, FINANCE DIRECTOR
 SUBJECT: PROVIDE STAFF DIRECTION REGARDING PLANNING FOR MEASURE D SUNSET

RECOMMENDED ACTION

It is recommended that City Council provide staff direction for impending Measure D sunset.

BACKGROUND

At the March 20, 2018 City Council meeting, Finance Department staff presented an informational report on fiscal strategies to maintain City service levels and to address the sunset of Measure D. The report addressed the various challenges affecting the City's long-term financial sustainability and explored several revenue options to replace Measure D. Additionally, through the FY17/18 mid-year budget review process, the Finance Committee recommended the inclusion of funding for a consultant to evaluate the City's options for financial sustainability through revenue measures and expenditure reductions. On April 3, 2018, City Council approved a Professional Services Agreement with Urban Futures, Inc. ("UFI") to: 1. Establish a ten-year baseline financial forecast model for the General Fund and 2. Provide a revenue and expenditure analysis, which identifies opportunities for revenue restructuring and/or ballot measure options as well as an assessment of General Fund expenditure categories.

On May 29, 2018, City Council held a Special Meeting to receive the General Fund Stability and Recommendations for Financial Sustainability Report from UFI. In the report, UFI's Managing Principal, James Morris, outlined a summary baseline forecast for the City's General Fund, presented a summary of findings, conveyed fiscal stabilization and financial sustainability recommendations, and concluded with the next steps required. Completion of the summary baseline forecast found that absent significant changes to revenue or the structure of service, annual operating deficits would begin in 2022, subsequent to the sunset of Measure D, which if continued, will lead to a cash insolvency in fiscal year 2024.

Recommendations from UFI to thwart insolvency and ensure the City's financial sustainability included:

- Revenue increases of \$4 to \$6 million annually

- Cost reductions to include restructuring of the City's delivery model and seeking cost concessions from labor organizations
- Continuing to implement strong core financial policies
- Adopting labor cost containment strategies

Knowing the gravity of the City's financial position should appropriate action not be taken prior to the sunset of Measure D, City Council directed staff to bring back a recommendation between two of the revenue measures outlined in the UFI report: a Utility Users' Tax (UUT) or a permanent continuation of the increased General Fund Transfer (GFT). Additionally, the City Council requested staff to provide an analysis of the financial impact of both options on residents and businesses.

ISSUES/ANALYSIS

The Baseline Forecast, as presented in the UFI report, clearly demonstrates that the operating deficit that begins in FY2021-22 is a permanent gap given the current level of City services, which must be closed by permanent increases in revenue or permanent decreases in expenses (e.g. permanent loss of services). Any revenue measure that is temporary or sunsets simply pushes the fiscal cliff further out for future Councils to address. Therefore, staff's recommendation is to avoid limiting any measure under consideration to a specific or sun-setting term.

Utility User's Tax

Utility User's Tax (UUT) is a percentage tax based on the consumption of utilities, such as telephone, cellular phone, video service, electric, gas, water, sewer, and refuse hauling. The City of Colton's UUT sunset in June 2011, and a replacement measure was not returned to voters. The City's previous tax rate on utilities was 6 percent for industrial/commercial users and 4 percent for residential accounts, so the tax paid on a \$50 commercial phone bill was \$3.00 and \$2.00 for a residential account. The City's Utility User Tax yielded approximately \$4.8 million in General Fund revenue annually.

The City's utility tax collections have been adversely impacted by various trends in recent years. Cable service technology and platform changes and video tax from cable service has been reduced significantly. This trend is anticipated to continue as more options become available. Water and electricity-based UUT revenue has the potential to trend downward due to water conservation efforts and efforts to reduce greenhouse gases. Further, on May 9, 2018, the California Energy Commission (CEC) adopted standards requiring solar systems for new single-family homes. The CEC estimates the requirement will cut energy usage in new homes by more than 50 percent. Regulatory compliance with the CEC's requirement will significantly influence the City's ability to yield UUT revenue for general purposes from new development. As such, a UUT implementation may not be the most effective means of raising additional revenue to fund quality City services.

The UFI report identified that re-adoption of the 2011 UUT rates “is likely sufficient to maintain General Fund budget solvency if coupled with some cost reduction strategies.” However, despite UFI’s low degree of certainty that the 2011 UUT tax structure would be sufficient, the report contained the added caveat that additional cost reductions would simultaneously be necessary. The prior UUT structure was only tested with the baseline financial forecast that assumed no increases to salary and benefit levels, no significant demand for additional services, and no additional unforeseen pension expense pressures.

Permanent Increase to General Fund Transfer (GFT)

As proposed, the impact of a permanent increased GFT is effectively similar to a UUT imposed on electric utility charges. The increased GFT amount would be included in the electric utility rates and is spread across all electric utility customers, both residents and businesses. Similar to the UUT, the increased GFT is consumption based. A permanent increase to the General Fund Transfer, like the UUT, risks exposure from tightened regulatory compliance affecting electric consumption. However, an increase in the GFT differs from a UUT in that it would only affect electric utility consumption, while the UUT would impact all utility usage.

The administration and audit of a permanent increase to the GFT is less staff intensive than the administration of a UUT, creating a labor cost efficiency in revenue collections and monitoring. The notification requirements for new utility vendors, compliance monitoring, and administrating exemptions associated with a UUT require additional staff resources not required by an increase to the GFT. The benefit of a permanent increased GFT lies in the administrative flexibility to raise and lower the amount within the voter-approved percentage based on the cost of general funded services.

To provide a comprehensive evaluation of the impact of a UUT versus an increase to the GFT for all customer types would require the City to retain a consultant to analyze the cost of service and perform a formal rate study. Given the compressed timeframe to perform an analysis, staff was limited to a basic comparison of the potential impact to a typical residential customer. The residential UUT rate assumption in the example below is based on the prior 2011 UUT rate of 4%. The basic calculation below for the increased GFT applies the same percentage increase (8%) to an average residential electric bill as would be factored in for the overall increase in operational expenses to accommodate for the increased GFT.

	Average Monthly Residential Bill	Residential UUT (4%)	Increased GFT (8%)
Electric	78.85	3.15	6.31
Water	59.99	2.40	-
Sewer	34.33	1.37	-
Refuse	24.77	0.99	-
Gas	15.00	0.60	-
Telephone/Wireless	100.00	4.00	-
Cable	75.00	3.00	-
		15.52	6.31

Depending on the subscription to optional utility services and the consumption of variable rate utility services, the average residential customer has the potential for greater financial impact resulting from the application of a UUT than an increase to the GFT.

The two primary factors influencing staff's recommendation to move forward with a permanent increase to the GFT are: 1. Administering the transfer based on the annual budgetary need to provide general City services yields the flexibility to increase or decrease the GFT amount within the voter-approved parameters and 2. The cost of administering and auditing the increased GFT revenue is significantly less than the cost associated with the administration, audit, and management of exemptions required of a UUT.

Ballot Measure Timing

To make an informed decision on the timing of placing an initiative on the ballot, both general election cycle dates in advance of the sunset of Measure D are further evaluated below for Council consideration:

NOVEMBER 2018

Pros

- Allows the City more than one opportunity to take a measure to the ballot for a general election (does not include the possibility of a special election)
- Adequate time to plan and implement resulting changes
- Assures our community of City leadership's commitment to seek solutions in advance of a fiscal crisis
- Will positively impact the City's credit rating and outlook

Cons

- The shortened timeline to the ballot
- Community perception of the City's proximity to the impending fiscal cliff may hinder voter approval
- Passage of proposed statewide measure could impact the required passage rate of a municipal measure by requiring two-thirds rather than a simple majority
- Voter fatigue resulting from multiple ballot measures on the same ballot

NOVEMBER 2020

Pros

- Gives adequate time to plan and prepare informational material
- Allows for more specific voter information, in terms of what services may be impacted, should the measure fail
- Impacts of statewide measure on November 2018 ballot will be known, giving the parameters for municipal ballot measure passage

Cons

- The City will only have one opportunity on a general election to pass a ballot measure; failure of a measure in November 2020 will leave one opportunity for the City Council to declare a fiscal emergency and place a measure on a special election in 2021 prior to the sunset of Measure D
- A different Council term will determine placement on the ballot
- Implementation of resulting changes will not allow adequate planning for revenue collection in advance of the sunset of Measure D with UUT option
- City credit ratings negatively impacted by inaction
- Uncertainty of financial outlook may negatively impact recruitment and retention of qualified City staff
- Future statewide legislation and ballot measures are unknown at this time

Any direction to place a measure on the November 2018 ballot would require City Council adoption (by a minimum 2/3 supermajority) of a resolution and submission to the Registrar of Voters prior to the August 10, 2018 deadline.

FISCAL IMPACTS

Given the current level of City services, the long-term General Fund sustainability is predicated on the City's decisions to seek solutions for the imminent operational deficits created by the sunset of Measure D.