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Staff Report for a City of San Leandro City Council Resolution to Approve the Measures HH, OO, PP and NN Citizens' Oversight Committee's Annual Report for Fiscal Year 2017-18

SUMMARY AND RECOMMENDATIONS

In November 2010, the City of San Leandro passed a temporary sales tax increase, Measure Z. Measure Z increased the City sales tax by $\frac{1}{4}$ percent over a seven-year period. On November 4, 2014, Measure HH, a half-cent sales tax was approved by more than 60% of City voters, to extend Measure Z at the new half-cent rate for 30 years. The ballot language assured voters that Measure HH receipts, which expire March 31, 2045, would provide revenues to cover vital City services (see table below), be subject to annual audits and reviewed by a citizens oversight committee, see **Table 1 on Attachment 1**.

Measure HH replaced Measure Z effective April 1, 2015. The attached table reflects pre-Measure Z cost cutting proposals, which were avoided due to the passage of Measure Z and Measures HH, OO, PP and NN. The results in the table reflect use of revenues for the life of the measures listed in Table 1.

Measures OO, PP, and NN were approved by the voters in November 2016. Each measure passed by more than 66%. The ballot language promises to enhance City services including but not limited to:

- Enhancing City infrastructure
- Enhancing library programming for children

- Improving social services

This report is scheduled for presentation to the San Leandro City Council on December 3, 2018.

BACKGROUND

On November 4, 2014, Measure HH, a half-cent sales tax, was approved by 65% of voters. The ballot language assures voters that Measure HH must expire March 31, 2045, and tax receipts are subject to annual audits, and an annual review by a citizen's oversight committee.

On July 6, 2015, the City Council passed a resolution that created the Measure HH Citizens Oversight Committee. The City Council defines the scope of responsibility and duties of the Measure HH Oversight Committee to include developing an annual report on the following:

- Amounts of Transaction and Use Tax revenue generated by Measure HH
- Use of the tax revenue and the impact on the City operating budget including a statement on the impact of the revenue in reducing the amount of cuts resulting from addressing the budget shortfall.
- Statement of expenditures funded by Measure HH revenues
- Impacts of Measure HH on local business competitiveness and the collection of Sales Tax revenues
- Measure HH public information and transparency efforts
- Participation in developing a revenue sustainability plan and strategy

During FY 2017-18, the City accrued three months of sales tax data related to Measure HH. The data was provided by the State Board of Equalization; the data is typically at least three months in arrears.

The Measure HH Oversight Committee held its first meeting on September 29, 2015, where it made several recommendations and discussed its annual report. City staff supports the work of the Committee by producing financial information and community priorities supporting the need for Measure HH. Audits have produced unqualified opinions from the City's independent auditor. These audits and budgets adopted by City Council have received awards from the Government Finance Officers Association. The audit for fiscal year 2017-18 is currently underway; it is not expected to conclude until January 2019.

The City receives 1.5 cents of the 9.75 cents per dollar in sales tax. This figure includes the 0.25% statewide sales tax reduction that took place at the end of 2016 due to the expiration of Proposition 30. The current allocation of the 9.75 cents sales tax can be found in **Table 2 on Attachment 1:**

In November 2016, San Leandro voters approved Measures OO, PP, and NN. The Measures passed and took effect January 1, 2017. A summary of these measures and revenue estimates through June 30, 2018 is set forth below.

1. A cannabis business tax of up to 10% of gross receipts;
2. A modified business license tax that reduces fees for small businesses, while charging up to 10% of gross receipts for parking lots, and also charging \$100 per 1,000 square feet of real property that is used for warehouse businesses; and
3. An increased transient occupancy tax to 14%.

These revenue sources align with previously adopted City Council goals and policy priorities, as outlined below. Furthermore, these revenue sources would not directly impact the vast majority of San Leandro residents, as a significant portion would be paid by businesses, and hotel and airport visitors.

Overview of Potential Cannabis Business Tax - no revenue as of this report, although the opening of the first dispensary is currently anticipated in January, 2019

Now that the City has issued three cannabis dispensary permits, the City has an opportunity to derive an important new source of revenue from these businesses. Similar to many other communities that have permitted the operation of cannabis businesses, the tax in San Leandro is based on the cannabis dispensaries' annual gross receipts. Given that the specific rates of such taxes vary by jurisdiction, coupled with the rapidly evolving legal and regulatory landscape surrounding the cannabis industry, the ballot measure was structured such that the tax amount would be "up to" 10% of gross receipts. The language allows the City flexibility to modify the rate over time up to the maximum 10% threshold. The ordinance has also been structured such that it would apply to any business involving the use of any component of the cannabis plant.

Given that no permitted cannabis dispensaries are yet operating in San Leandro, there is uncertainty as to how much revenue will be derived from the tax. However, based upon revenue estimates provided by permit recipients (Harborside San Leandro, Blum San Leandro and Davis Street Wellness Center) as part of the submitted application materials for their dispensary permits, staff estimates that this revenue measure could potentially generate more than \$500,000 per year based on the current City Council-adopted rate of 6% of gross receipts.

On March 20, 2017, the City Council authorized a tax structure that gradually increases over several years to maximum of 8%.

Overview of Modifications to the Business License Tax - \$1,150,000 received through June 30, 2018

The modifications to the business license tax were designed to align the City's business license tax rates with City Council priorities to support small businesses located in San Leandro, while also incentivizing the productive use of the City's industrial areas.

Small Business Discount:

As structured in the ordinance, the per-employee component of the business license tax for small San Leandro businesses with three or fewer employees is eliminated. Previously, these businesses paid a flat fee of \$128.20 per year, plus a per-employee fee that varies by business type. The per-

employee fee was waived for small businesses.

This modification results in a tax reduction for approximately 2,300 small businesses located in San Leandro and a decrease in business license tax revenue of \$106,000 in FY 2017-18.

Warehouse Rate Change:

Additionally, an amendment to the business license tax ordinance modifies the tax rate applied to warehouse and distribution businesses. They were previously charged a flat fee of \$128.20, plus a per-employee fee. The amended ordinance now charges them \$100 per 1,000 square feet of building space. The rationale for this change is to align the business license fee with the impact such businesses impose on city resources and services, much of which comes from the physical size of their business rather than the number of employees. Warehouse and distribution businesses cause heavy wear on local streets through truck and delivery traffic, but generate relatively few jobs and limited business license revenue or sales tax. By modifying the business license tax rate based on square footage, the tax better reflects such businesses' impacts on City infrastructure and services. The additional business license revenue to be generated from this change in collection methodology is \$510,000 in FY 2017-18.

Parking Lot Range Change:

Lastly, the ordinance modified the business tax rate that is applied to parking lots (such as those providing long-term parking for Oakland International Airport). Previously, parking lots paid a flat fee of \$128.20, plus \$38.50 per parking space. The new ordinance charges such businesses a rate of 10% of gross receipts. In comparison, the rate in Oakland is set at 18.5% of gross receipts. The rate would enable the City of San Leandro to capture additional revenue while still providing parking lot businesses in San Leandro a competitive advantage over those located in Oakland. The estimated additional business license revenue to be generated from this change in collection methodology is \$750,000 in FY 2017-18.

In summary, staff estimates that the above modifications to the City's business license tax, which align the taxes collected with the economic priorities of the City, could generate more than \$1,154,000 annually, while simultaneously reducing the tax burden for approximately 2,300 small businesses located in San Leandro.

Overview of Increase in Transient Occupancy Tax - \$455,000 received through June 30, 2017

The City's previous transient occupancy tax (TOT) was 10%, which is charged to travelers when renting overnight accommodations of a limited duration in a hotel, inn, tourist home or house, motel or other lodging located within San Leandro. Other communities in the region have established higher rates, including the cities of Oakland and San Francisco, each of which presently have TOT rates of 14%. In addition, the redevelopment of the San Leandro shoreline area is expected to result in the creation of at least one new hotel in San Leandro, which could provide an important source of additional TOT revenue in the future. An additional \$455,000 in annual revenue is anticipated, with the potential for greater increases in the future as new hotels are constructed.

ANALYSIS

Amounts of Transaction and Use Tax revenue generated by Measure HH

The adopted Budget approved in June 2017 anticipated \$11.2 million in Measure HH tax receipts for FY 2017-18. Actual receipts were \$11.2 million. The City was allocated its Measure HH sales tax

starting April 1, 2015, but it did not budget a full year of receipts until FY 2015-16. The first receipts were received in the fall of 2015.

Use of the tax revenue and the impact on the City operating budget including a statement on the impact of the revenue in reducing the amount of cuts resulting from addressing the budget shortfall

The Measure HH revenue is available for any legal expenditure by the City. In the context of public safety, the annual revenue represents about 28% of the police department's FY 2018-19 budget, which is \$40.0 million, and 45% of the fire department budget, which is \$24.9 million. Without Measure HH in FY 2018-19, the sworn police officers totaling 93 could be cut by as much as 26 positions (if \$11.2 million was removed from the police department budget). Similarly, for the fire department 63 firefighters could be down 30 positions (if all \$11.2 million was eliminated from its budget). The ballot also indicated that Measure HH would sustain 9-1-1 emergency response times, neighborhood police patrols, investigation and gang suppression officers, library hours/programs, street and pothole repairs, youth and after-school and senior programs, and other general City services. The City preserved funding for these programs and projects because of Measure HH funds.

The pie chart, see **Chart 1 on Attachment 2**, indicates that a total of 56% will be spent on public safety in FY 2018-19. The remaining 44% will fund libraries, parks, community development, infrastructure improvements, repairs, maintenance, and administration. The General Fund Transfers have decreased from 9% to 7% reflecting a \$2.5 million decrease to capital improvements, such as the Police Department, Shoreline and recreation infrastructure. The abbreviations used in the pie chart are Rec (Recreation and Human Services Department), Gen Govt (General Government - City Attorney, City Clerk, City Council, Human Resources, Finance and City Manager), Comm Dev (Community Development Department), and Engineering (Engineering and Transportation). Non-dept. (non-departmental) costs are General Fund debt service, retiree medical, community investment and events, and leases. The City's FY 2018-19 budget, which ends on June 30, is currently balanced.

Impacts of Measure HH on local business competitiveness and the collection of Sales Tax revenues

Sales tax increases have occurred at a rate greater than the average rate for other cities in Alameda County since the inception of the Measure Z quarter cent sales tax. Five other cities in Alameda County have a 9.75% total rate: Alameda, Albany, Hayward, Newark and Union City. The other 9 cities in the County have 9.25% total sales tax rates. General sales tax increased 3.0% in 17-18, indicating that Measure HH has little effect.

Measure HH public information and transparency efforts

Measure HH revenue has been highlighted in the City Council's adopted budget. In the City Council adopted biennial budget message, the following excerpt states: "Measure HH is approved for a 30 year period and promises to protect and maintain City services. The November ballot language mentions 911 emergency response, neighborhood police patrols, anti-gang enforcement, and library programs for children, adults and families. The successful measure also supports after school programs for youth including homework assistance and reading programs, school resource officers, and crossing guards. The measure will also help fill potholes and maintain residential streets. The FY 18-19 budget provides funds for police infrastructure, library improvements, park improvements,

Casa Peralta and street enhancement totaling \$7.7 million. Additionally, \$20 million new money bonds are contemplated by the end of 2018 to augment these projects”.

Participation in developing a revenue sustainability plan and strategy

On July 7, 2014, City Council approved ballot language on the November 4, 2014 ballot that replaced the Measure Z ordinance, which was expiring in March 2018, and extended a ½ cent rate for 30 years.

The basis of this initiative is the provision of services and infrastructure which will deteriorate unless additional funds are available to the City. A scientific survey conducted by Godbe Research predicted the strong support for the new initiative as long as it supports the following services provided by the City:

- Maintaining 9-1-1 emergency response times
- Maintaining neighborhood patrol officers
- Maintaining library programs for children, adults & families
- Enhancing anti-gang and law enforcement efforts
- Maintaining fire prevention services
- Repairing potholes/cracks, maintaining residential streets
- Maintaining investigation & gang suppression officers

The Committee endorsed these taxes, which are expected to generate an additional \$1.5 million per year. The services listed above have all been maintained or enhanced with the support of Measure OO, PP, and NN.

Committee Review and Action

The Measure HH, OO, PP and NN Citizens Oversight Committee met on August 30, 2018 to review the performance, the adopted budget and to advance the report for City Council approval.

Attachments

- *Attachment 1 - Table 1 and Table 2*
- *Attachment 2 - Pie Chart*

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