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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 2018-19

SUMMARY AND RECOMMENDATIONS

In November 2014, the Measure HH half-cent sales tax was approved by more than 60% of city voters. The ballot language assured voters that Measure HH receipts would provide vital General Fund revenues supporting a range of City services, be subject to annual audits, and be reviewed by a citizens' oversight committee.

Measure HH superseded Measure Z (a quarter-cent sales tax measure approved in 2010) effective April 1, 2015. In addition, Measures OO, PP, and NN were passed by voters in November 2016. Each passed by more than 66% of voters. The measures were passed to maintain and enhance City services including:

- Public safety and emergency services.
- Code enforcement.
- Parks and infrastructure.
- Library programming for children.

BACKGROUND

On November 4, 2014, the Measure HH half-cent sales tax was approved by 65% of city voters. The

ballot language provided that Measure HH would run through 2045 and that receipts would be subject to both annual audits and review by a citizen's oversight committee.

On July 6, 2015, the City Council passed the resolution creating the Measure HH Citizens Oversight Committee. The City Council defined the responsibilities and duties of the Oversight Committee to include developing an annual report covering the following:

- Amounts of revenue;
- Use of the tax revenue and the impact on City operating budgets including statement on impact of revenue in reducing amounts of cuts resulting from addressing the budget shortfall;
- Statement of expenditures funded by the Measure's revenues (Summary, Table 1);
- Impacts of the Measure on local business competitiveness and the collection of other revenues;
- Information for the public and transparency; and
- Promotion of public participation in developing a revenue sustainability plan and strategy.

Measures OO, PP, and NN were passed by voters in November 2016. Each also required independent citizen oversight.

The Measure HH Oversight Committee held its first meeting on September 29, 2015, discussed the annual report, and made several recommendations. City staff supported the work of the Committee by producing financial information and community priorities supporting the need for Measure HH. Annual audits have produced unqualified opinions from the City's independent auditor. Both audits and City budgets adopted by the City Council receive awards from the Government Finance Officers Association. The audit for 2018-19 is currently underway and expected to conclude prior to December 31, 2019.

Table 1 (Attachment 1) reflects expenditure cutting proposals (identified related to Measure Z, the original sales tax measure approved in 2010) that were avoided with passage of Measure Z and later by Measures HH, OO, PP and NN. The results shown reflect use of revenues over the life of the measures.

Measure HH

Measure HH authorized a 0.50% Transaction and Use Tax that increased the total sales tax rate on retail sales in San Leandro to 9.50%. Of the total rate, 1.50% flows to the General Fund, supporting the full range of municipal services. At the time of approval, the total combined tax rate in the city became 10%. Subsequently, the rate in the city lowered to 9.75% with the expiration of Proposition 30 in 2016-the temporary increase in sales tax preventing cuts in the California education budget. The current breakdown of the sales tax rate in San Leandro is shown in Table 2 (Attachment 2).

Measures OO, PP, and NN

In November 2016, San Leandro voters approved Measures OO, PP, and NN. The Measures passed and took effect on January 1, 2017 and in summary include:

- Business license taxes reduced for small businesses and charging 10% of gross receipts for parking lots and also charging \$100 per 1,000 square feet for property used for

warehouse/storage and wholesale/distribution businesses.

- Transient occupancy tax increased to 14%.
- Cannabis business tax of up to 10% of gross receipts (currently 6%).

These revenue sources align with previously adopted City Council goals and policy priorities as outlined below. These revenue sources minimize impacts on a majority of San Leandro residents, as a significant portion is paid by a select number of businesses and individuals from outside the city, such as hotel and airport visitors.

Analysis of Required Information for Annual Report

➤ Amounts of revenue generated by Measures

Measure HH

Transaction & Use Tax revenue totaled \$12,396,300 in 2018-19. This amount exceeds the budget by \$900,500 and is 4% greater than total actual received in 2017-18. Transaction & Use Tax revenue has increased annually since 2016-17 though the state began collecting and allocating tax proceeds to the City beginning April 2015.

Measure OO

Measure OO revised the business license tax schedule levying a gross receipts provision (10%) on parking lots and a square footage charge (\$100 per 1,000 square feet) on warehouse and distribution businesses. Business license revenue totaled \$6,697,700 in 2018-19. Of this total, categories including Parking Lots (\$588,900), Warehouse/Storage (\$238,400), and Wholesale/Distribution-General (\$425,400) were a total of \$1,252,700.

Measure OO modified the tax rate applied to parking lots (primarily long-term parking for the Oakland International Airport). Previously, parking operators paid a flat fee plus a per-space charge. In comparison with the City's 10% gross receipts rate, the rate in Oakland is set at 18.5%. The new rate formula enables San Leandro to capture additional revenue while maintaining a competitive advantage over similar businesses in Oakland.

Additionally, Measure OO modified the tax rate applied to warehouse and distribution businesses. They were previously charged a flat fee and a per-employee fee. The ordinance now charges \$100 per 1,000 square feet of building space. This change aligns the business license fee with the impact of such businesses, primarily coming from the physical size of their business rather than number of employees. Warehouse and distribution activity cause heavy truck wear on local streets while creating few jobs and limited business license revenue or sales tax.

Offsetting the tax rate increases, Measure OO eliminated the per-employee component of the business license tax on small San Leandro businesses with three or fewer employees. This modification results in a tax reduction for approximately 2,300 small businesses and initially decreased business license tax revenue by \$150,000.

Measure PP

Measure PP increased the City's Transient Occupancy Tax (TOT) from 10% to 14%. TOT is collected from travelers occupying a hotel, inn, tourist home or house, or motel for a limited duration.

Oakland also has a 14% rate (Alameda and Hayward currently have lower rates at 10% and 8.5%). Future development at the Shoreline Area is expected to create at least one new hotel providing additional TOT revenue.

In June of this year, the City Council adopted an ordinance regulating short-term rentals (STR) and authorized the hiring of a third party on-line company to monitor STR listings for compliance with the ordinance including paying TOT. Staff does not anticipate significant TOT revenue as a result of this action, though will continue to monitor revenue generated by newly registered listings to ensure they are paying the tax.

In Fiscal Year 2018-19, General Fund Transient Occupancy Tax revenue totaled \$965,700, and an additional \$836,300 was recorded in the Shoreline Enterprise Fund. Of the total TOT revenue of \$1,802,000 recorded in both funds, \$514,200 results from the increased rate approved by Measure PP.

MEASURE NN

Cannabis Add-on Tax revenue totaled \$53,300 in 2018-19 from Blum San Leandro, the only permitted dispensary thus far to commence operations in the City as of the writing of this report (the cannabis tax is added to the standard business license fee for retailers). This amount is less than the 2018-19 budget of \$510,000-reflecting the limited, six-month operation of only one of three previously permitted cannabis retailers. It is also important to note that the dispensary was limited to only medical cannabis sales for the first several months of operation, further constraining its sales activity and corresponding taxable receipts.

As in other communities with permitted cannabis operations, 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 to provide the City Council with flexibility in the rate that would be applied, up to a maximum of 10% of gross receipts.

Given the nature of the legal cannabis industry, it is uncertain how much on-going revenue will be eventually derived from the tax. Based on revenue estimates provided by the three permit recipients (Blum San Leandro, Harborside San Leandro and NUG Wellness Center) as part of their application materials, staff previously estimated that this revenue measure could ultimately generate \$500,000 annually. However, these estimates were developed prior to enactment of Proposition 64 that legalized statewide adult use of cannabis and established new regulatory requirements and additional statewide taxes that could not have been foreseen.

The City Council authorized a tax structure presently at 6% of gross receipts and that is scheduled to increase over a three-year period to 8%, absent further adjustments. Effective May 1, 2019, the City Council expanded the operational definition of locally permitted cannabis dispensaries (medical only) to also allow adult use sales without a physician's recommendation letter.

Table 3 (Attachment 3) summarizes the 2018-19 revenues received by the City from the voter-approved Measures.

- **Use of the tax revenue and the impact on City operating budget. Include statement on impact of the revenue in reducing the amount of cuts resulting from addressing the budget shortfall**

Measures HH and OO, PP, and NN

Measure HH and OO, PP, and NN revenue may be used for any legal, General Fund expenditure by the City. The total General Fund revenue related to the four Measures is \$14,668,000. This total equals 11% of all General Fund revenue in 2018-19.

The significance of the combined revenues from Measures HH and OO, PP, and NN are seen in the context of departmental expenditures including public safety. The total of \$14,668,000 represents 36% of the total Police Department's 2018-19 budget and 58% of the Fire Department budget in 2019-20. Eliminating the Measures' revenue would be equivalent to eliminating funding for 56 of the Police Department's 71 Police Officer positions.

Measure HH indicated passage would sustain 9-1-1 emergency response times, neighborhood police patrols, investigation and gang suppression officers, library hours/programs, street and pothole repairs, youth after-school and senior programs, and other general City services. All of these services have been based on approval of all the tax measures.

Chart 1 (Attachment 4) shows a total of 57% of City expenditures are budgeted for public safety in 2019-20. The remaining 43% will fund libraries, parks, community development, general government, infrastructure improvements, and all repairs and maintenance. The total of \$14,668,000 from the tax measures at least double all other individual departments' expenditures. In fact, the total combined expenditures for the Recreation & Human Services, Library Services, and Engineering & Transportation departments only slightly exceeds \$14,668,000.

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

Measure HH

The City's sales tax consultants, Avenu Insights & Analysis, report seeing no data indicating any change in consumer behavior (across many clients) based on sales tax rate differences. Sales tax revenue has increased in San Leandro at a greater rate than has the average increase for all cities in Alameda County since the inception of Measure Z. Five other cities in Alameda County have a 9.75% rate: Alameda, Albany, Hayward, Newark, and Union City. The other 9 cities in the County have 9.25% sales tax rates. General sales tax revenue in San Leandro increased 7% in 2018-19, further indicating that Measure HH has little adverse impact.

➤ **Measure HH public information and transparency efforts**

Measures HH and OO, PP, and NN

Measure HH revenue has been highlighted in the City Council's Adopted Budget. In the Budget Message, it is stated: *Measure HH is approved for a 30 year period and promises to protect and maintain City services. These include 911 emergency response, neighborhood police patrols, anti-gang enforcement, and library programs for children, adults and families. It also supports after-school programs for youth including homework assistance and reading programs, school police officers, and crossing guards. The funds also help fill potholes and maintain residential streets. Projections indicate the City will receive \$11 to 13 million per year from Measure HH.*

In addition, the Budget Message points out: *This year's budget includes revenues that have been previously passed by voters and are now contributing to the fiscal stability of the organization.*

Revenue from Measure OO assesses a tax to cannabis businesses, Measure PP increased the City's Transient Occupancy Tax (TOT) to 14% on lodging in the City, and Measure NN increased the business license tax on parking lots and warehouses and reduced the tax for small businesses are all contributing factors to the City's revenue stream.

➤ **Participation in developing revenue sustainability plan and strategy**

Measures HH and OO, PP, and NN

On July 7, 2014, City Council approved ballot language for the November 4, 2014 ballot replacing the Measure Z ordinance that would expire in 2018, and extended a half-cent rate for 30 years. The basis of this initiative is the provision of services and infrastructure that would deteriorate without additional funding. A voter survey concluded strong support for these efforts as long as they are directed toward the following services:

- 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; and
- Maintaining investigation and gang suppression officers

The services listed above have all been maintained or enhanced with the support of Measure HH, OO, PP, and NN.

Committee Review

The Measure HH, OO, PP and NN Citizens Oversight Committee reviewed this report and supports advancing it for City Council approval.

Attachments

- Attachment 1-Table 1, *Potential Service Reductions Funded Through Measures HH and OO, PP, and NN - Table 1 and Table 2*
- Attachment 2-Table 2, *Description of Sales and Use Tax Rate: San Leandro*
- Attachment 3-Table 3, *2018-19 Revenue by Line Item Account, HH and OO, PP, and NN*
- Attachment 4-Chart 1, *Budgeted Expenditures, 2019-20*

PREPARED BY: David Baum, Finance Director