



**CITY OF PACIFICA
COUNCIL AGENDA SUMMARY REPORT**

2/14/2022

SUBJECT:

Vision 2025 & Beyond – Fiscal Sustainability Analysis, Potential Revenue Options, and Ballot Measure Analysis & Communications Services

RECOMMENDED ACTION:

Receive, discuss, and provide direction to the City Manager on the updated 10 Year Financial Forecast and Options to Maintain the Current Level of City Services.

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INTRODUCTION:

The Vision 2025 & Beyond - Fiscal Sustainability Analysis, Potential Revenue Options and Ballot Measure Analysis and Communication Services was scheduled for presentation at the City Council meeting held on January 24, 2022. The staff report was published as part of the agenda and was ready to be presented to the Council when a technical issue with the live stream broadcast forced the early adjournment of the meeting. This staff report serves to continue this item, already in progress, at the February 14, 2022 City Council meeting with the same materials.

At the December 13, 2021, City Council meeting, staff presented an update to the City Council on the Vision 2025 & Beyond Strategic Financial Sustainability Study. This study, which was identified by the City Council as a priority beginning in Fiscal Year 2019-20, has the following Purpose Statement as refined by the City Council on October 12, 2020:

The Purpose of the Pacifica Vision 2025 & Beyond project is to tell Pacifica's story of the many priority infrastructure projects, and enhanced programs and services envisioned for Pacifica's mid to long-term future that are equitable and inclusive and will help all Pacificans thrive, and to articulate the City's financial opportunities, challenges, and strategies to achieve this vision and resiliency.

As presented in December 2021, the study includes these five components:

1. Financial Forecasting and Revenue Enhancement Strategies
2. Economic Opportunities Study
3. Pacifica Marketing Study & Marketing Plan
4. Public Engagement and Surveys
5. Public Information Final Report

At the December 2021 meeting, the Council received reports and focused on items II (Economic Opportunities Study) and III (Pacifica Marketing Study & Marketing Plan), provided input on the Statement of Work for the Economic Opportunities Study, and approved the City Manager's

recommendation to release a Request for Proposals for this component in January, 2022. At the same meeting, the City Council, together with the Economic Development Committee in a joint study session, provided feedback on the Pacifica Marketing Study prepared by Creative Digital Agency (CDA) and approved the City Manager's recommendation to develop an agreement with CDA for a 2-year marketing plan and return to City Council in early 2022 for consideration of approval of that agreement.

Since that meeting, Staff has continued work on these two components of Vision 2025 & Beyond. The Request for Proposals (RFP) for the Economic Opportunities Study has been updated to include the suggestions and additions from the City Council. The RFP has been issued on January 28, 2022 and proposals are due on March 7, 2022. The Shop Pacifica program continues to move ahead in its "soft launch" phase, with almost \$2,000 being added to date to the Pacifica economy through Gift Card purchases that are starting to be redeemed by recipients at merchants in Pacifica (15 signed up to date).

Finally, at the December 2021 meeting, staff reported that the City's Chief Fiscal Sustainability Officer had begun working with City Staff, HdL (the City's Revenue Consultant), and Financial Consultants, to refine a preliminary 10-Year Financial Forecast to return to the City Council in early 2022 to present the forecast, alongside an initial assessment of Revenue Enhancement Strategies (including voter-approved revenue measures) that might be feasible to help maintain, or enhance, the current level of City services, as well as fund Capital Projects and infrastructure needs in Pacifica.

Therefore, the purpose of tonight's Vision 2025 & Beyond discussion is to present the refinements of the preliminary 10-Year Financial Forecast to clearly communicate the City's fiscal sustainability challenges and to discuss a variety of potential revenue measures that have been preliminarily evaluated for their revenue-generating capacity. **The City Manager is seeking City Council direction about which potential revenue measures should advance to the next phase of feasibility assessment, including engagement of a consultant for ballot measure analysis and communications services.**

BACKGROUND:

Updated 10 Year Financial Forecast

During the 2021-22 Budget process, the City Council was presented with a 10 Year Financial Plan. That plan has been updated by the Chief Fiscal Sustainability Officer for tonight's Vision 2025 & Beyond discussion and is attached to this report as **Attachment A**.

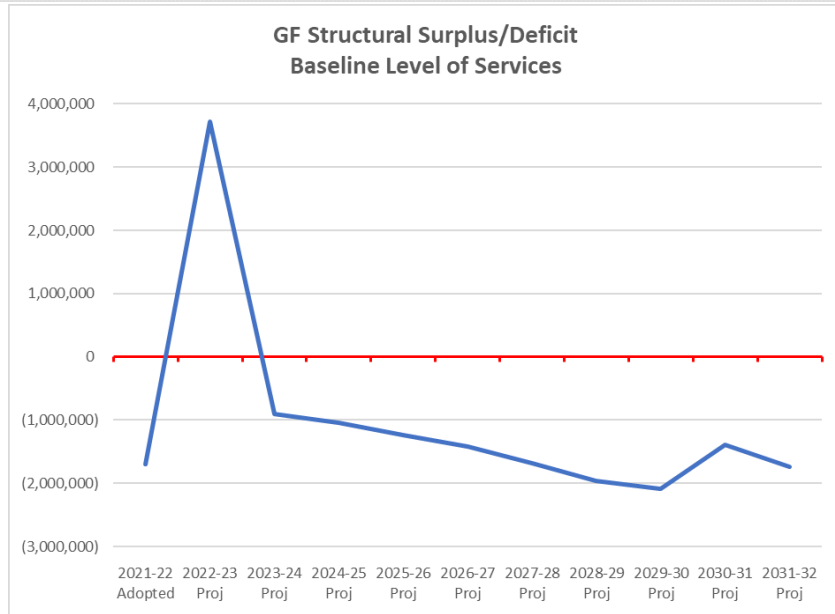
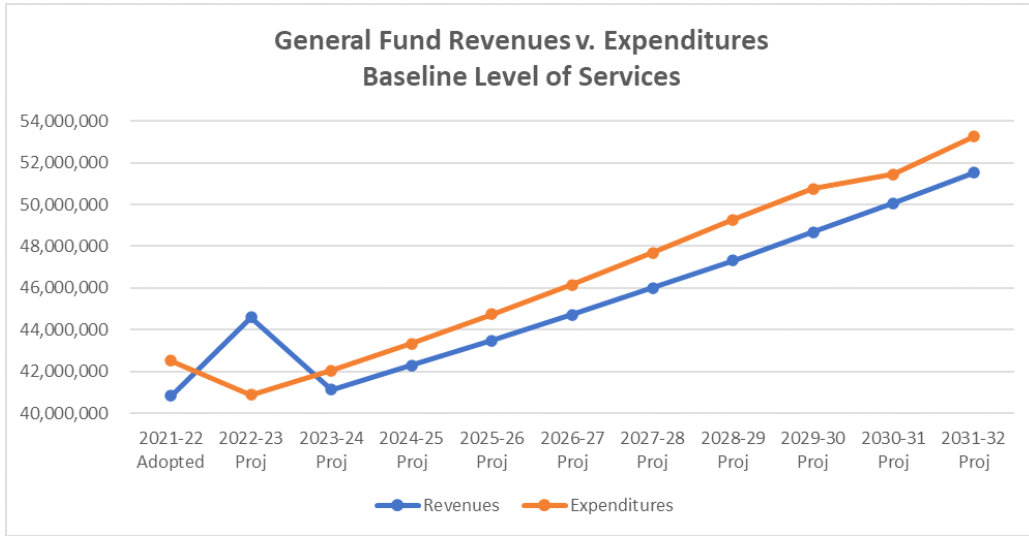
The updated plan considers current revenue and expenditure trends at the mid-year mark. It also adjusts for PERS Retirement and Year 2 labor union MOU expenses, removes limited-term positions in the budget, assumes annual debt service for the Civic Center Renovation project, does *not* assume any ongoing General Fund contribution towards the capital improvement program, and reflects a 14% increase in PERS unfunded liability from the prior year.

With these updates, the City's Operating Budget that covers ongoing services to the community will remain in balance during the current 2021-22 fiscal year and the upcoming 2022-23 fiscal year. This is in part due to the availability of American Recovery Plan Act (ARPA) funds that offset losses of City revenues during the Covid pandemic plus the payment of In Lieu Vehicle License Fees from the State. However, these funds will be spent by the end of the 2022-23 fiscal year resulting in a financial deficit in future years.

Projected Financial Deficit Starting in 2023-24 Fiscal Year

Starting in the third year of the financial forecast, the City will experience a shortfall in funds to maintain the current level of City Services. This shortfall is projected to be \$0.9 Million in 2023-

24, growing to \$1.1 Million the following year (2024-25) and reaches \$2.1 Million in FY 2029-30, as summarized in the charts and table below.



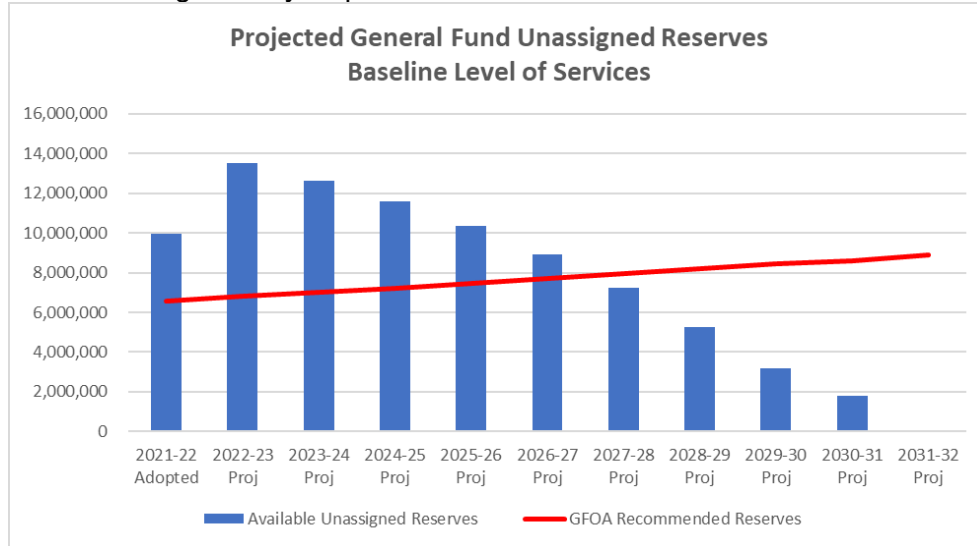
<u>Fiscal Year</u>	<u>Projected Deficit</u>
2023-24	905,502
2024-25	1,045,390
2025-26	1,238,878
2026-27	1,421,768
2027-28	1,688,929
2028-29	1,957,370
2029-30	2,082,106
2030-31	1,384,675
2031-32	1,742,239

Budget Deficit Impact on General Fund Reserves in Future Years

If the structural budget deficit beginning in the 2023-24 fiscal year remains unaddressed, the City’s unassigned General Fund Reserves will continue to shrink and eventually fall below the Government Finance Officers Association (GFOA) recommendation for government entities of

no less than two months of regular general fund operating expenditures.

Maintaining sufficient reserves is necessary for fiscal and operational sustainability, which becomes especially critical in the current uncertain economic situation. Therefore, staff always strives to go above the minimum recommendation for General Fund undesignated fund balance. The prospect of it falling below the minimum threshold guidelines presents a significant challenge to maintaining the City’s operations and is not sustainable.



ADDRESSING BUDGET CHALLENGES & PROJECTED DEFICIT

Actions and Strategies to Address Budget Challenges

The City of Pacifica has historically worked to reduce expenditures in the Annual Budget to live within existing revenue means. This has meant cutting positions and managing salary growth to the point where the organization and capacity for service provision is inadequate to meet the needs and desires of the community.

There are components of the Vision 2025 & Beyond study that will focus on revenue enhancement strategies through non-tax methods, such as economic development and marketing, including efforts to develop additional hotel capacity and increase visitation to improve Transient Occupancy Tax and Sales Tax revenues. In addition, Staff will be working on updating User Fees and Development Impact Fees in the City. This work will help improve the City’s financial sustainability in the years to come.

However, the reality is that, even with these non-tax revenue enhancement strategies, the City is facing a projected deficit in the near term. Continued revenue enhancements are needed to 1) maintain the current level of services, as well as 2) tackle organizational capacity and retention challenges, and 3) address neglected infrastructure needs and any additional operational costs.

To keep Pacifica structurally sustainable at a level of expected service delivery and capital improvement project funding envisioned by the community, it is anticipated the Council and the community will need to consider voter-approved revenue measures in the future as a necessary strategy.

POTENTIAL REVENUE MEASURES

Potential Revenue Measures

The December 2021 presentation about Vision 2025 & Beyond mentioned this next step of analyzing some of the City's key revenues to determine what the financial impact would be of bringing certain revenues to be on par with other agencies in the region.

With the assistance of the City's tax consultant, HdL, staff has identified several potential revenue sources that could be considered by the Council to address the City's revenue shortfall in future years. They are summarized in the table below, followed by a more detailed description.

<u>Revenue Option</u>	<u>Annual Revenue (Net Increase)</u>
UUT - Broaden Base	3,100,000
UUT - Cut Rate to 5%, Broaden Base	2,000,000
Local Sales Tax @ .50c	2,600,000
Local Sales Tax @ .25c	1,300,000
Business License Update	500,000
TOT - 12% to 15%	350,000
TOT - 12% to 14%	280,000

Utility User Tax (\$2 Million to \$3.1 Million annually)

Cities may impose a Utility User Tax (UUT) on utility services including electricity, gas, water, sewer, and telecommunications. Utility companies are responsible for collecting the taxes and remitting them to the City. Utility user tax rates throughout the State range from 1 % to 11%.

The City of Pacifica has a Utility User Tax (UUT) of 6.5% that is charged on electricity and gas. In the 2019-20 fiscal year, the UUT generated \$1.7 Million in revenues.

Currently, the UUT is not collected on telecommunications (phone and cable TV), prepaid wireless, or water. In other cities, these utilities are also subject to UUT. If these categories were added to the UUT in Pacifica at the current 6.5% UUT rate, an additional \$3.1 Million in revenue would be received.

Alternatively, the City could broaden the categories of the UUT but lower the tax rate from 6.5% to 5%. This combination of broader categories but a lower tax rate would increase revenue by \$2 Million per year.

Local Sales Tax (\$1.2 Million to \$2.4 Million annually)

The City of Pacifica currently receives one percent of the sales and use taxes from the State. This generates \$2.6 Million per year in revenues.

Cities may impose sales tax rates to be added to the statewide "base". The add on rates are "transactions and use taxes" and are allocated to the jurisdiction where the taxed product is received. Over 100 of the 482 cities in California have enacted local transactions and use taxes of up to one percent. Under state law, the maximum combination of transactions and use tax rates in any location may not exceed two percent.

According to estimates provided by HdL, if Pacifica were to adopt a Local Add-On Sales Tax (Transactions & Use Tax) of one-half cent it would generate approximately \$2.6 Million per year.

A quarter cent Local Add On Sales Tax would generate approximately \$1.3 Million per year in Pacifica.

Business License Tax (\$500,000 annually)

The Business License Tax (BLT) is charged to anyone doing business in a City. It is a common revenue used to fund City services throughout California with over 450 of the 482 cities in California levying a BLT. The BLT recognizes the link between City services and infrastructure and the use of these by local businesses.

Pacifica requires all businesses operating within the City to obtain a business license and pay business license tax per section 3-1.101 of the City's Municipal Code. This revenue is locally controlled and funds essential services. The City currently issues over 2,100 business licenses annually and, over the last five fiscal years, has generated an average of \$440,000 in business license tax revenues per fiscal year.

HdL has done some initial analysis of the City's Business License Tax Ordinance. This includes suggestions on updating the language of the ordinance, reducing the number of tax categories from 7 to 4, and updating the tax rates. The current tax structure has been in place since 1984 and is complex. There are seven different classifications with different rates that are not structured along industry lines. As a result some businesses pay a flat \$40, plus 30c per one thousand dollars of annual gross receipts over \$25,000, while other business license tax classifications have the business pay a minimum of \$100, plus 77c per one thousand dollars of annual gross receipts over \$25,000. The recommendation to charge different rates based on business activity would simplify the number of business classifications, improve equitability and increase business tax revenue. Less complexity in the tax structure may also lead to increased business attraction and retention. By reforming the tax structure, the City will make it easier for businesses to correctly report their taxes and provide better fiscal stability to the City and make it more in-line with the neighboring cities that have recently revisited their business license tax structure.

The proposed changes are estimated to generate up to an additional \$500,000 per year in business license tax revenue.

Transient Occupancy Tax (\$280,000 to \$350,000 annually)

Transient Occupancy Tax (TOT) (also known as a Hotel Tax) is charged as a percentage of a room rate to people who occupy a hotel, motel, inn, or other forms of transient lodgings (short-term rentals) for thirty (30) days or less. The tax is collected by the lodging operator and is remitted to the City by the lodging operator. It is a revenue that has been used to fund City services throughout California and has been adopted in 430 of the 482 cities in the State. Pacifica's rate is currently 12%, totaling approximately \$1.7 Million per year in TOT revenue.

Many cities raised their TOT rates from 12% to 14% over the past 4 years. TOT rates have also gone beyond 14% in two local cities - Half Moon Bay (15% effective on July 1, 2022) and Palo Alto (15.5%). Staff is also aware that additional cities are considering TOT rate increases and other revenue measures to address their projected budget shortfalls at their next elections.

If Pacifica increased its TOT tax rate from 12% to 14%, that change would bring in an additional \$280,000 per year in revenue. Increasing the TOT tax rate from 12% to 15% would bring in an added \$350,000 per year.

Other Revenue Measures

In addition to the revenue options detailed above, the Council may also consider other revenue measures to address the City's projected budgetary deficit or other priority service level

enhancements. These options could include a General Obligation Bond to fund one or multiple major infrastructure projects, such as for street rehabilitations, new libraries, and the Beach Boulevard Infrastructure Resiliency Project. The City Council may identify other needs and measures to achieve those needs, such as an idea raised by Councilmember O'Neill about a special hotel tax to help fund playing field improvements in collaboration with the Pacifica School District, so the City Manager is seeking input on any of these other types of ideas.

General Taxes and Special Taxes

The provisions of the State Constitution adopted as part of Proposition 13 in 1978, and Proposition 218 in 1996 define local taxes as either "General Taxes" or "Special Taxes". This language requires that *"local governments may not impose, increase, or extend: (1) any general tax, unless approved by a majority vote at a general election; or (2) any special tax, unless approved by a two-thirds vote."*

Therefore, whether a measure is a General Tax or Special Tax is a critical point to analyze in preparing for the feasibility of a voter-approved ballot measure. The UUT, BLT, TOT, and Local Sales Tax measures described above can be structured as General Taxes requiring majority vote only. Such measures also have to occur in a General Election. The next General Election in Pacifica will be held in November 2022, followed by November 2024.

RESTORING CITY SERVICES, ENHANCING SERVICES & CAPITAL PROJECT NEEDS

Given the size of the City's projected financial shortfall starting in 2023-24 to maintain the current level of City Services, Staff has not yet explored the added cost of restoring City Services cut in prior years, enhancing the current level of City services, or funding major infrastructure and Capital Improvement Project needs. The Vision 2025 & Beyond study process will include public engagement about what types and levels of City services and capital projects the City Council and the community envision for Pacifica's future. This vision for Pacifica's future will inform what types of voter-approved revenue measures, combined with non-tax revenue enhancement strategies, will comprise the best financial sustainability strategy that is acceptable to the community.

ALTERNATIVES TO POTENTIAL REVENUE MEASURES

Based on staff's projections, the ongoing need to continue the current level of City services for the Pacifica community and maintain the minimum level of reserves for the next ten years of the financial outlook is estimated at \$1.9 million to \$2.3 million per year.

This Financial Outlook projection was prepared to reflect the current level of services and operations. The projection does not take into account challenges that face Pacifica today. These challenges include the City's organizational capacity being severely hampered by limited staffing resources that are significantly leaner than other comparable agencies and compensation levels that are lower than other comparable agencies. Exceptionally lean staffing and compensation levels below median of comparable agencies do not make for a sustainable organizational model.

If voter-approved revenue measures are not approved in the future, whether or not in combination with non-tax revenue enhancements, to close the upcoming gap in revenues compared to projected expenses, the City most likely will be faced with repeating its history of service and personnel reductions. Since the City is already very lean, such reductions likely will require very noticeable structural service-level changes.

NEXT STEPS

At tonight's meeting, the City Manager is seeking the Council's direction on which potential revenue measures should advance to the next phase of feasibility assessment. Once Staff has received that direction, work will continue advancing this matter for discussion with the Council and the community. That process will include the following steps:

1. Further work on assessing the feasibility of placing one or more revenue measures on the November 2022 ballot.
2. Retaining a firm to work with the City on educational outreach and public engagement on the potential revenue measure.
3. Returning to the City Council for a decision on moving ahead with a revenue measure - most likely in April.
4. If the Council moves ahead with a revenue measure, developing the proposed ordinance(s) and ballot measures on a timeline to meet County ballot requirements - likely in May or June.

ALTERNATIVE ACTION:

The City Council may decide to direct staff to take alternative actions to address the projected City budget deficit starting in the 2023-24 fiscal year. These may include:

1. One or more of the alternatives and options described earlier in the **Alternatives to Potential Revenue Measures** section of this report.
2. The City Council may want to pursue additional revenue options to address needs beyond the current level of services described in the **Restoring City Services, Enhancing City Services & Capital Project Needs** section of the report.

RELATION TO CITY COUNCIL GOALS AND WORK PLAN:

This item advances the Vision 2025 & Beyond program and furthers the City Council's Strategic Goals and the City's efforts towards **Fiscal Sustainability**.

FISCAL IMPACT:

Funding to continue work on the Vision 2025 & Beyond study is included in the 2021-22 budget. As work commences to further develop any potential revenue measure for the November 2022 ballot, including retaining a firm to assist with education, outreach, and polling, staff will assess whether there is a need for additional funding for this work at that time.

ORIGINATED BY:

City Manager's Office

ATTACHMENT LIST:

Attachment A - Long-Term Financial Forecast (PDF)