

STAFF REPORT

City Council Study Session Agenda Item

DATE: April 1, 2024

TO: Honorable Mayor and City Council Members

FROM: Merritt Perry, City Manager

SUBJECT: Transactions and Use Tax Measure

STAFF RECOMMENDATION:

Discuss and consider an increase of the City’s existing 0.75 percent transactions and use tax to generate necessary revenue to fund essential public safety services.

EXECUTIVE SUMMARY:

In November 2016, a majority of voters approved a local 0.75 percent transactions and use tax (Measure E) with the intention of funding previous cuts to public safety and to help maintain and enhance public safety services, support local businesses, provide essential services, and stabilize the City budget. The sales tax was originally set to expire on March 31, 2025; however, in November 2020, a majority of voters approved an extension of the tax through March 31, 2033.

Measure E generates approximately \$1.8 million per year and is essential for the City to maintain and continue to improve essential City services. However, as discussed in more detail below, the City has experienced a significant increase in the cost of providing essential services since 2016 and additional funds are necessary to meet current and projected costs.

Accordingly, the purpose of this study session is to consider and provide direction to staff as to whether the Council would like to propose a measure to the voters to increase the transactions and use tax.

DISCUSSION:

A. Transactions and Use Tax; Generally.

Pursuant to Chapter 3.13 of the Fortuna Municipal Code, the City currently levies a 0.75 percent transaction and use tax on goods sold at retail within the City. A transactions and use tax is levied on the same purchases as the statewide sales tax, with some minor exceptions. Retailers and other merchants collect the tax at the time of sale and remit the funds to the California Department of Tax and Fee Administration, which administers the tax under contract with the City. The state then transmits the funds collected to the City.

Unlike the state-wide sales tax of which the City receives an allocation, **all** tax revenue generated by the City’s transactions and use tax is remitted to the City for its general use and is subject to annual audits with expenditures overseen by an independent community oversight committee.

B. Revenues and Expenditures of Measure E Funds.

The combined sales tax rate in the City is 8.50 percent. Of this amount, the State receives 6.00 percent, the County Transportation Fund receives 0.25 percent, the County receives 0.50 percent (with the passage of the County's Measure "Z") and the City of Fortuna receives 1.0 percent (Bradley-Burns). The City's Measure E transactions and use tax adds another 0.75 percent, which brings the total sales tax rate to 8.50 percent.

During fiscal year (FY) 2022-23, the City received \$1,844,883 (net of administration costs of \$12,150) from the City's transactions and use tax. This represents receipts received for the period of July 2022 through June 2023. These revenues represent approximately 18 percent of the City's total general fund revenue. Attached as **Attachment A** is the Oversight Committee's Annual Report to the City Council which describes revenues and expenditures for the prior fiscal year.

Measure E revenues partially or fully fund a variety of essential public services, such as Fortuna Police Department positions (including a detective, patrol officer, community services officer, clerk, code and compliance officer), Fortuna Police Department programs (including code compliance, encampment outreach, K-9 services, and the new police station project), public works programs, and parks and recreation programs.

Over the long term, costs to provide services that depend on the general fund including police, general services, and parks and recreation will continue to increase and ultimately require nearly all of the funding generated by Measure E. In Fiscal Year 2022/2023, the amount of funding in excess of that needed by the departments normal operation that could be used for special projects was at a high of \$785,000. With the escalation of costs for items such as health care, fuel, wages, equipment and materials increasing over 9% in one year, the amount available for special projects has diminished to \$375,000, a decrease of over \$400,000 in just two years. Additionally, the City's compensation of employees generally runs lower than other Humboldt County Cities and the County and this makes it difficult for the City to recruit and retain quality employees. For example, Eureka and Arcata offer a \$50,000 hiring bonus for lateral transfers for police and offer higher paying salaries (in excess of 10%). Those Cities continue to increase its salaries above what the City of Fortuna can offer. Eureka has a 1.5% transaction and use tax compared to the City of Fortuna's 0.75% and a higher proportion of retail sales that puts Fortuna at a disadvantage. Increasing the City's transaction and use tax will allow the City to continue to have more competitive salaries and fund special programs beyond normal operation. Should the city choose, they could also identify other public safety priorities for funding such as fire protection services. Not pursuing additional tax revenue will make it harder for the City to recruit and retain employees and limit the ability to do special projects.

C. *Options for Increasing the Tax Rate.*

i. *Rate Adjustment.*

Pursuant to state law, the City may impose a transactions and use tax at a rate of one-eighth of one percent, or a multiple thereof, up to a maximum of two percent. Accordingly, should the Council elect to propose a measure to the voters to increase the rate, the Council may increase the rate by multiples of 0.125 percent as follows:

	Rate	Proj Additional Revenue**
Current	0.75	---
	0.875	\$ 307,481
	1.0	\$ 614,961
	1.125	\$ 922,422
	1.25	\$ 1,229,922
	1.375	\$ 1,537,403
	1.5	\$ 1,844,883
	1.625	\$ 2,152,364
	1.75	\$ 2,459,844
	1.875	\$ 2,767,325
	2.0	\$ 3,074,805

** Projections are based upon revenues received in the 2022-23 FY (i.e., \$1,844,883)

The Council also has the discretion to propose a temporary increase of the existing rate for a period of years less than the amount of years remaining on the current tax, which runs through March 31, 2033. Following the expiration of the temporary increase, the current rate would become the effective rate again through March 31, 2033.

The Council may also consider extending the current expiration date beyond March 31, 2033, as such an extension also requires voter approval.

ii. Process to Propose an Increase to the Voters.

The City Council does not have the authority to establish, extend, or raise taxes unilaterally; instead, pursuant to Proposition 218, the Council may propose a new or increased tax to the voters for approval. A general tax (such as the City’s transactions and use tax) requires approval by majority of voters at a general election, the next one being November 2024. A special tax requires approval by two-thirds of the voters at general or special election.

To place a general tax measure on the November 2024 ballot, the City Council will need to take certain actions no later than the first meeting in May 2024. In particular, the Council will need to approve, by 2/3rds vote, the submission of a proposed ordinance increasing the existing tax rate and adopt a resolution that, among other things, requests that the County Board of Supervisors consolidate the City’s tax measure with the County-facilitated state-wide election on November 5, 2024. The County Election’s Office normally requires Cities to submit the proposed ordinance and resolution of consolidation in June to allow time for action by the Board of Supervisors.

To meet this deadline, staff recommends the following timeline:

Meeting Date	Action Item
April 1, 2024 (Study Session)	Provide direction to staff on Council desire to pursue increase in tax rate and discuss intended expenditures
April 15, 2024 (Regular Meeting)	Initial review of proposed ordinance and resolution seeking consolidation
May 6, 2024 (Regular Meeting)	Consider submission of ordinance to the voters and adoption of resolution seeking consolidation

Following the Council approval of the ordinance and adoption of the resolution seeking consolidation, staff will submit those items to the County and thereafter follow the process for drafting of arguments for the measure, rebuttal argument (if necessary), and City Attorney's impartial analysis.

If the voters approve the measure, the new tax rate would become effective April 1, 2025.

iii. Designation of Expenditures for Increased Revenues.

Although a general tax and therefore not legally restricted to any particular use, the City Council may designate particular programs or services to be wholly or partially funded by the incremental revenues derived from the rate increase. The Council has wide discretion to designate programs and services to be funded.

RECOMMENDED COUNCIL ACTION:

1. Receive staff presentation and review Council questions with staff;
2. Take public comment; and
3. Deliberate and provide direction to staff as appropriate.

ATTACHMENTS:

- A. Annual Report for FY 2022-23 of the Measure E Oversight Committee