



ARCATA

CALIFORNIA

MEMORANDUM

Date: July 7, 2023
To: Transaction and Use Tax Oversight Committee
From: Tabatha Miller, Director of Finance
Subject: Review and Recommendations on Potential Tax Revenue Sources

The Arcata City Council has requested that the Transaction and Use Tax Oversight Committee (TUTOC) review potential tax revenues and make recommendations to the City Council on possible new source(s) to potentially present to the Arcata City Voters next calendar year. The additional revenue is necessary for the City to continue current services and programs that are only possible because of one-time revenues including grants, American Rescue Plan Act (ARPA) funds, salary savings from staff vacancies and the post-pandemic bump in spending as reflected in FY 2021 and 2022 sales tax revenues.

Programs that have had success in our community but do not have an ongoing funding source include:

1. Community Ambassador Program – estimated annual cost \$150,000;
2. Safe Parking Program – estimated annual cost \$685,000;
3. Juvenile Diversion Counselors – estimated annual cost \$290,000;
4. Mobile Intervention Services Teams (MIST) and Street Outreach Programs (including dedicated Sergeant) – estimated annual cost \$265,000;
5. Valley West Neighborhood Support - estimated annual cost \$75,000;
6. Extreme Weather Shelter - estimated annual cost \$30,000-\$50,000, depending on severity and length of extreme weather events;
7. Recruitment and retention efforts for Police Officers - estimated annual cost \$225,000;
8. Increased street striping, overlay and pedestrian improvements - estimated bi-annual cost \$350,00; and
9. Valley West Community Center/Police Office Space (Woodsman Building Lease) - estimated annual cost \$150,000 to \$200,000.

The majority of the programs set forth above, are housed within our Police Department as they build capacity to provide alternate response options. These are non-sworn options to improve community health and safety through proactive relationship such as the community ambassadors

or safe parking programs or through non-sworn field response such as MIST and Juvenile Diversion Counselors.

Correspondingly, elected officials and staff continue to receive increased requests for officer presence in neighborhoods and business districts to make residents, students, visitors and the public at large feel safe. California cities, including Arcata, continue to struggle with the impacts and needs of those struggling to find and/or remain housed, and individuals struggling with mental health and/or addiction. The public continues to ask government at all levels to solve or at the very least better manage these issues.

The City, like many agencies, businesses and families, continues to struggle to keep up with increasing costs, particularly labor costs. Police shortages are impacting staffing capacity across the nation and Arcata continues to struggle with adequate levels of staff resources. Pension costs have been and are continuing to increase at rates well above inflation. The City's employee pension expenditures have increased an average of 11% per year for the last five years and are projected to jump by 40% in FY 2024-25, as the result of significant losses from California Public Employees' Retirement System (CalPERS) investments.

Arcata's current .75% Transaction and Use Tax (TUT) can support any general fund program but was passed by the voters and is monitored by this committee to maintain, when possible, support for streets and public safety, with approximately two-thirds of the revenue dedicated to streets expenditures and one-third to the police department operations. In fiscal year 2022-23, the City is estimated to spend \$3.4 million on street maintenance and improvements and \$8.1 million on police services, including \$1.1 million on improvements to the police department's radio system. In FY 2021-22, the City spent \$4.2 million on street maintenance and improvements and just under \$6 million for the police department operations. As set forth below the TUT is estimated to contribute \$2.65 million towards those expenses in FY 2023-24.

Potential Sources of Additional Tax Revenue

Although there are other opportunities for increasing revenue for the City, taxes provide a stable source with the potential to generate sufficient dollars to fund the more expensive programs that support the City Council and community priorities such as an effective Homelessness Reduction Strategy, which includes providing temporary emergency shelter, long-term housing, and wrap-around services and support. Potential tax revenue sources for consideration by the TUTOC are discussed below.

To provide background information, the actual and budgeted tax revenues for Arcata for the Fiscal Years 2021 to 2024 are set forth in the chart on the next page. Tax revenues in total reached a peak in FY 2021-22, are projected to dip down in FY 2022-23, and remain flat in FY 2023-24. Very modest growth in tax revenue is projected for the next several years.

Description	FY 2021 Actuals	FY 2022 Actuals	FY 2023 Estimated Actuals	FY 2024 Adopted Budget
Sales Tax (State Bradley Burns)	\$ 2,946,963	\$ 3,083,415	\$ 2,975,000	\$ 2,950,000
Transactions & Use Tax (2)	2,694,215	2,826,138	2,655,000	2,656,000
Property Taxes	1,773,138	1,711,716	2,006,226	1,889,000
Transient Occupancy Taxes (2)	1,638,280	2,029,499	1,525,000	1,575,000
Utility Users Tax (2)	1,130,348	1,030,498	1,100,000	1,155,000
Franchise Fee Revenue (Solid Waste) (1)	415,414	446,904	410,000	492,000
Franchise Fee Revenue	279,072	282,624	275,000	278,000
Open Space Parcel Tax (1)	-	168,165	168,700	168,000
Excessive Electricity Use Tax (2)	222,773	204,979	120,000	140,000
Business License Tax (2)	130,700	139,928	75,000	116,000
Real Property Transfer Tax	56,587	66,461	43,300	45,000
Special Assessment Revenue (1, 2)	35,973	36,436	37,452	37,970
Recreation Fee for New Constr.(1)	82,930	46,444	95,000	30,000
Parkland In Lieu Fees (1)	29,608	3,496	13,000	14,000
Total Tax Revenues	\$ 11,436,002	\$ 12,076,703	\$ 11,498,678	\$ 11,545,970
<i>(1) Revenue sources are special revenues that must be used for stated purposes only</i>				
<i>(2) Revenue sources may be increased or expanded although most require voter or stakeholder approval.</i>				

Local Transaction and Use Tax

The City’s local Transaction and Use Tax (TUT) rate is currently .75% or three-quarters of a cent for every dollar spent. “Measure G”¹ generates approximately \$2.65 million a year. The Transaction and Use Tax Oversight Committee was created with the stated purpose to review the “Measure G” public works (streets) and public safety activity annually and in November each year to make recommendations to the City Council on expenditures for the following year.

Although the TUTOC monitors spending on streets and public safety and the tax was and continues to be committed to this purpose, it was presented and passed by the voters as a “general tax”, which only requires a simple majority (50% plus one) and is not legally restricted to that purpose. A “special tax”, as opposed to a “general tax”, is legally restricted for a specific use and requires a super majority or two-thirds voter approval to pass. The difference in votes required between the simple majority and super majority is often the reason municipalities place general tax measures instead of special tax measures on the ballot.

Local municipalities (Cities and County combined) are limited to 2.0% additional tax above the state’s base rate of 7.25%.² Arcata’s .75% Measure G plus the County’s .50% “Measure Z” tax, leaves up to .75% capacity for a new or increased Arcata TUT tax. Local TUT taxes may be established or increased in 1/8th or .125% increments.

¹ Measure G was the name of the original ballot question when TUT was first voted on in 2008.

² Some municipalities have sought authority to exceed the 2.0% additional tax limit by receiving permission from the State Legislature. Humboldt County has indicated that they will be seeking permission to exceed the limit in order to propose a TUT that would be collected in both the incorporated city limits and the unincorporated county (like Measure Z) to fund county roads in the unincorporated county. This is likely motivated by the fact that the tax rate in Eureka is already at the cap of 9.25% and without the additional sales tax capacity, the County could not collect the new tax (if passed) in Eureka, where more than 50% of the sales tax for the whole county originates.

Every additional .125% increment in TUT for Arcata would generate approximately \$425,000.

Transient Occupancy Tax

The City's current Transient Occupancy Tax ("TOT" - sometimes referred to as Bed or Hotel tax) rate is 10% with an additional 2% collected as a Business Improvement District (BID) assessment which is remitted to the Humboldt County Tourism Business Improvement District. Unlike TUT, TOT rates are set at the discretion of the City and are not subject to a cap on amount. The most common rate for California cities is 10%, but a few cities, including Anaheim and Palo Alto have rates at or above 15%.³ In June 2022, Humboldt County (in unincorporated portions of the county) and Trinidad successfully increased their TOT rate to 12%. At its peak in FY 2022, TOT generated just over \$2 million for Arcata. The revenue has and will continue to decline as a result of converting two hotels to Project Homekey housing and the use of hotel rooms by Cal Poly Humboldt to subsidize student housing needs.

Based on current revenue projections, every 1% increase in Arcata's TOT would generate \$150,000.

Utility Users Tax

Arcata's current Utility User Tax (UUT) rate is 3%, excluding the 45% tax on excessive electric usage and in November of 2022, was renewed by Arcata voters to November 30, 2036. The UUT applies to water, wastewater, electric, gas and communication services in Arcata. Like the TOT, there is no legal cap on UUT, so the amount is at the discretion of the City and its voters. Rates in California range from 1% to 11% with the most common rate at 5%.⁴

Based on current revenue projections, every 1% increase in UUT would generate approximately \$375,000 for the City of Arcata.

Parcel Tax

The City approved a flat \$37 per parcel special revenue tax in November of 2020 that must be used to protect, preserve, maintain and expand Arcata's parks, trails and open spaces. Because of the limitations placed on property taxes based on value by Proposition 13, parcel taxes are either a flat per-parcel tax or based on use, size or number of units on each parcel. Constitutional limits placed on Parcel taxes require that they must be special taxes.

Based on current revenue projections, every \$25 per parcel tax would generate approximately \$110,000.

Other Tax Sources

There are a number of other tax sources potentially available to the City, provided the voters support them. Those include Business Operations Taxes, which is a tax on the privilege of conducting business in the City. This tax can be a percent on gross receipts, a flat amount, or a

³ The California Municipal Revenue Sources Handbook, Fifth Edition, Michael Colman League of California Cities 2019

⁴ *Id.*

payroll tax. Documentary transfer taxes are imposed on documents exchanged in the transfer of interest in real estate. Admissions tax is a tax on the privilege of attending a show, performance, display or exhibition based on a flat rate or a percent of the price of the ticket. Parking taxes are imposed on the owner or operator of paid parking facilities. Construction/Development taxes are a tax on the privilege or activity of development and/or the availability or use of municipal services. Construction/development taxes are different than development fees. Development fees are used to mitigate or offset the impact of development and unlike development taxes cannot exceed the costs of providing services or facilities.

While these other tax sources, may be additional options to explore, at first review they did not appear to provide sufficient revenues to support the City Councils priorities without a significant impact on narrower groups of potential taxpayers.

General Tax versus Special Tax

This memo refers to general and special taxes and distinguishing differences. Proposition 13 created the distinction between a “general tax” and a “special tax” and Proposition 218 in 1996 further developed the procedures for establishing general taxes. Key differences to consider in developing recommendations are outlined below.

	General Tax	Special Tax
Use of Revenues	Unrestricted	Restricted
City Council Approval	Two-thirds (66.67%)	Majority (50% + 1)
Voter Approval	Majority (50% + 1)	Two-thirds (66.67%)
Other Rules	A general tax election must be consolidated with a regularly scheduled general election of the City Council unless an emergency is unanimously declared by City Council.	Special taxes must be deposited in a separate account and the City must publish an annual report including tax rate, amount of revenue collected and expended, and status of projects funded by the tax.

Current Challenges

City staff and the City Council understand that asking the voters to approve a tax increase in the current economic environment is a big ask. The same fiscal challenges the City is facing are being felt by local business, families, individuals, students and visitors. Each proposed new or increased tax option will impact groups of the public and voters differently – and this will need to be considered. Likewise, figuring out what services and programs are important enough for voters to fund is crucial.

Considerations

The City Council has asked for a recommendation from the TUTOC as to what tax source(s) would be best received by the Arcata voters, what is an appropriate amount, what services should be tied to the new revenue source(s) and if applicable whether the tax should be presented to the voters as a general or special tax. Additionally, the TUTOC may want to consider a recommendation on whether the City Council should consider hiring a consulting firm to research public perceptions on different tax options and the level of importance placed on the various service programs.