



# STAFF REPORT – CITY COUNCIL MEETING

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June 12, 2024

**TO:** Honorable Mayor and City Council Members

**FROM:** Tabatha Miller, Finance Director

**PREPARER:** Tabatha Miller, Finance Director

**DATE:** June 06, 2024

**TITLE:** **Place Transactions and Use Tax Measure on Ballot for November 5, 2024.**

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## RECOMMENDATION:

It is recommended that the Council:

- 1) Receive the staff report;
- 2) Take public comment;
- 3) Conduct City Council questions and discussion;
- 4) Adopt Resolution No. 234-52, which:
  - a. Places the three-quarters of one cent ( $3/4\%$  or  $.75\%$ ) addition to the City's Transactions and Use Tax Measure on the ballot for the General Election to be held on November 5, 2024 (**requires two-thirds or four affirmative votes from City Council Members**);
  - b. Submits Ordinance No. 1570 to the qualified voters at the November 5, 2024, general municipal election;
  - c. Requests consolidation of the election on the Sales Tax Ballot Measure with the Statewide General Election;
  - d. Sets dates for submission of arguments for and against the proposed tax measure;
  - e. Sets dates for submission of rebuttal arguments;
  - f. Authorizes the City Council or any member or members of the City Council authorized by the City Council, to write the argument for the measure;
  - g. Requests the City Attorney prepare an impartial analysis of the measure; and
  - h. Agrees to reimburse the County of Humboldt for the cost of conducting the election.

## INTRODUCTION:

At the April 2, 2024, study session, the Council directed staff to develop draft ballot measure language for possible adoption by the City Council at a future meeting. Staff provided sample language to the Council at the April 16, 2024, Special Meeting and the Council provided feedback which has been incorporated into the ballot measure language included in Resolution No. 234-52.

## BACKGROUND:

In July 2021, the City received the first of two equal payments from the Coronavirus State and Local Fiscal Recovery Funds (SLFRF) program authorized by the American Rescue Plan Act (ARPA).

The SLFRF program provided \$350 billion to state, territorial, local, and Tribal governments to support local governments' response to and recovery from the COVID-19 public health emergency. As a primary purpose of the SLFRF (generally referred to as ARPA) funding was to offset revenue losses suffered by local governments during the pandemic and to stimulate the economy, the guidelines for ARPA funding require that the funds be spent quickly and not saved.<sup>1</sup>

Approximately \$925,000 of the City's ARPA funding remains, for the new fiscal year beginning on July 1, 2024. Based on prior City Council feedback, those funds will be allocated for the annual salary of the Outreach Sergeant's position and Mobile Intervention Services Team (MIST), the Community Ambassador Program, a Valley West Community Center, the remaining term of the CUNA contract, completion of already allocated climate change projects, arts programs and other facilities improvements.

The \$4.4 million ARPA funding provided the City with opportunities to invest locally in new programs deemed important to the community but also delayed budget shortfalls, by providing the financial means to rehire six critical frozen positions<sup>2</sup> and supplementing much needed infrastructure maintenance and improvements. As the one-time ARPA funds are spent, projects, programs and staff supported by ARPA funding will require additional General Fund revenue and/or in the short-term use of one-time fund balance to be continued. In addition, the community has asked for and expects a number of the new services, including those that address homelessness and its impacts, and efforts to address climate change such as electrification of the City's vehicle and equipment fleet and building complete streets to provide accessible transportation alternatives.

Another fiscal challenge that faces Arcata, is the impact of adding new facilities without increasing the staff to manage and maintain those additions. The significant investment in the Capital Improvement Program (CIP) over the last several years was mostly funded from outside grants and allocations. While this significant investment of outside funds improves City services and provides local economic stimulus, the ongoing operation and maintenance costs for these assets will be borne by the City. For example, while much of the funding to build the soon to be opened Carlson Park was from grants and other state appropriations, the ongoing care and maintenance is unfunded and as such will compete for resources with existing programs and services.

### Structural Financial Deficit

A government "budget deficit" occurs when a government spends more than it receives in tax revenue. A "structural deficit" is when a budget deficit persists for some time, whether the economy is performing well or not. Structural deficits eventually pose a problem for governments, which must find ways to reduce expenses, which generally require some level of service reductions and/or find ways to increase revenue.

Like many other local governments, a pending structural deficit is not a new challenge. Prior to the pandemic, Arcata's long-term projections predicted that expenses, based on the current service levels, would exceed revenues. The increase in ARPA funding and other pandemic relief from the federal and state government, along with savings realized as Arcata temporarily cut back expenses in response to the pandemic, delayed the onset of a structural deficit. Recently, several California jurisdictions have sited structural deficits as the reason for declaring fiscal emergencies and asking

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<sup>1</sup> ARPA dollars must be obligated by December 31, 2024, and fully spent by December 31, 2026.

<sup>2</sup> Streets Maintenance Crew Leader, 2 Parks Maintenance Workers, Recreation Supervisors, Community Development Specialist and a Police Officer.

voters to approve tax increases.<sup>3</sup> Rising inflation and interest rates have also hastened the impact of this imbalance of revenues versus expenses.

**Chart 1** below provides a projection of the City’s financial status for the General Fund over the next five years. The FY 2025 Projected figures are based on the requested and revised budgets provided by City Departments. FY 2025 is the base year used for FY 2026-2029, with inflationary increases as noted just below the chart. The projections assume no new staff positions, no new programs and no new revenue sources over the five-year period. The General Fund is projected to have a “budget deficit” (expenditures exceed revenues) for all years presented, which will reduce unreserved fund balance to a negative figure by the end of FY 2029.<sup>4</sup>

**Chart 1 - General Fund 5-Year Financial Projections**

<b>Summary - General Fund</b>						
<b>Revenue &amp; Transfers</b>	<b>Estimated</b>	<b>Projected</b>	<b>Projected</b>	<b>Projected</b>	<b>Projected</b>	<b>Projected</b>
<b>Classification</b>	<b>FY 2024</b>	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
Taxes	11,044,000	11,241,500	11,466,330	11,695,657	11,929,570	12,168,161
Licenses & Permits	817,000	825,500	850,265	875,773	902,046	929,107
Fines & Forfeitures	210,000	160,000	163,200	166,464	169,793	173,189
Use of Money & Property	456,200	482,300	487,123	491,994	496,914	501,883
Intergovernmental Revenue	3,017,941	5,121,253	2,523,678	2,574,152	2,625,635	2,678,148
Charges for Services	613,400	531,796	550,409	566,921	581,094	595,621
Interfund Charges	2,066,770	2,123,340	2,192,349	2,269,081	2,348,499	2,430,696
Other Revenue	1,557,119	1,269,116	594,498	606,388	618,516	630,886
<b>Total Revenue</b>	<b>19,782,430</b>	<b>21,754,805</b>	<b>18,827,852</b>	<b>19,246,430</b>	<b>19,672,067</b>	<b>20,107,691</b>
<b>Expenditures</b>						
Personnel Services	11,048,935	13,170,032	13,489,646	14,170,697	14,631,245	15,106,760
Materials & Services	2,540,764	2,875,830	2,962,105	3,050,968	3,142,497	3,236,772
Interfund/Intergovt payments	1,134,206	1,167,546	1,190,897	1,214,715	1,239,009	1,263,789
Capital Outlay	2,996,391	7,017,589	2,428,117	2,500,961	2,575,990	2,653,270
Debt Service	2,574,395	74,536	73,489	73,206	73,200	73,456
<b>Total Expenditures</b>	<b>20,294,691</b>	<b>24,305,533</b>	<b>20,144,254</b>	<b>21,010,547</b>	<b>21,661,941</b>	<b>22,334,047</b>
<b>Incr./(Decr.) Fund Balance</b>	<b>(512,261)</b>	<b>(2,550,728)</b>	<b>(1,316,402)</b>	<b>(1,764,117)</b>	<b>(1,989,874)</b>	<b>(2,226,356)</b>
<b>Estimated Beginning Available</b>	<b>9,893,824</b>	<b>9,381,563</b>	<b>6,830,835</b>	<b>5,514,433</b>	<b>3,750,316</b>	<b>1,760,442</b>
<b>Estimated Ending Available</b>	<b>9,381,563</b>	<b>6,830,835</b>	<b>5,514,433</b>	<b>3,750,316</b>	<b>1,760,442</b>	<b>(465,914)</b>
FY 2025 Projected is based on City Dept. Requested budgets for revenue and expenses. FY 2025 Personnel Services assumes a 4.5% COLA and 15% increase in City's portion of health insurance. FY 2025 Personnel Services will potentially be adjusted once labor agreements are approved.						
FY 2026-2029 Projected Taxes, Intergovernmental (only includes ongoing revenue) and Other Revenue increased 2%. FY 2026-2029 Fines & Forfeitures, and Licenses & Permits 3%. Interfund Charges 3.25%. FY 2026-2029 Use of Money & Property increased 1%. Charges for Service increased (3.5%, 3.0%, 2.5%, 2.5%/CPI-U). Other Revenues reduced in FY 2026 to reflect additional operating transfer to Streets Funds (\$700,000).						
FY 2026-2029 Personnel Services increased 3.25%. In FY 2026 cost previously ARPA funded Sergeant added to Personnel Services. FY 2026-2029 Materials & Services and Capital Outlay (ongoing only, one-time funding excluded) increased 3%. FY 2026-2029 Interfund/Intergovt payments increased 2%. FY 2026-2029 based on Debt Service current debt schedules.						

**DISCUSSION:**

For a couple of years, a City Council’s Priority Project was to develop a Homelessness Reduction Strategy and identify an ongoing funding stream (i.e., sales tax, property tax), for voters to consider. Successful programs initiated as part of the Homelessness Reduction Strategy funded with one-time money such as the ARPA, Humboldt County Measure Z (not received in FY 2023-24 and only funded at \$45,600 in FY 2024-25 (1/5<sup>th</sup> of prior level) 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;

<sup>3</sup> To place measures on the March 2024 ballot, the City of Benicia, La Canada Flintridge and Chino declared fiscal emergencies in late 2023. Even the State considered declaring a fiscal emergency in response to the large budget deficit predicted for FY 2024-25.

<sup>4</sup> The General Fund fund balance in the chart is unreserved and does not include the \$5.9 million operating reserve, set at 30% of the General Fund’s annual operating expenditures. For fiscal year 2024 and FY 2025, the deficit spending or use of fund balance is the result of capital projects and other one-time expenses prioritized by the City Council.

4. Mobile Intervention Services Teams (MIST) and Street Outreach Programs (including Outreach dedicated Sergeant) —estimated annual cost \$295,000; and
5. Extreme Weather Shelter—estimated annual cost \$30,000-\$50,000, depending on severity and length of extreme weather events; and
6. Valley West Neighborhood Support - \$100,000.

Since Proposition 13 was passed in the late 1970s, essentially all options for local governments to increase revenues require voter approval.<sup>5</sup> As a result, it will be Arcata’s eligible voters who participate in the election that decide whether a new tax is approved.

As presented at the April 2, 2024, City Council Work Session, the FM3 Research Community Survey found that 72% of the 567 registered voter respondents support a three-fourths (3/4) of one cent Transactions and Use Tax (TUT) measure which would allow the City to maintain essential services such as:

- Road, stormwater, parks maintenance,
- Police patrols and clinical mental health response to people in crisis,
- Emergency/disaster response and climate change adaptation,
- Services addressing homelessness and its impacts,
- Youth after-school and summer programs,
- Bus services,
- and general government purposes.

Local sales taxes are paid when goods subject to the tax are purchased within Arcata City limits or in some cases, discussed below, when those goods are delivered into the city limits. This means that the tax burden is spread among residents, visitors, businesses, employees and governmental agencies, including the City of Arcata. Local sales and use taxes do not apply to groceries, prescribed drugs, medical and dental services, real estate, rent, education, utilities, personal services, labor, diapers or feminine hygiene projects. Local TUT revenues must be spent locally and cannot be taken by the state or federal government.

### California Local Sales Tax Rates

Local California sales and use tax rates range from 7.25% to 10.75%. A complete list of City and County Sales and Use Tax rates is provided in Attachment 3. While California Government Code caps local sales tax at 9.25% (7.25% State share plus voter approved special add-on taxes not to exceed a total of 2.0% by local cities, districts and/or the county), the Legislature may increase the cap.<sup>6</sup>

The City of Arcata’s current Sales and Use Tax rate is 8.50% and would increase to 9.25%<sup>7</sup> if the voters approve this TUT increase on November 5, 2024. **Chart 2** below sets forth the tax rates for jurisdictions in Humboldt County.

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<sup>5</sup> A General Tax must receive two-thirds approval by City Council to be placed on the ballot and then a simple majority of voters approval. A Special Tax requires only a simple majority of City Council but two-thirds approval by the jurisdiction’s voters.

<sup>6</sup> On 10-8-2023, Governor Newsom signed AB 1256 which allows Humboldt County to exceed the cap by 1.0% , if the proposed tax is approved by the voters.

<sup>7</sup> The 9.25% does not include a possible Humboldt County TUT increase.

**Chart 2 - Humboldt County Jurisdictions Sales and Use Tax Rates**

<b>Jurisdiction</b>	<b>Current Sales Tax Rate</b>
Arcata*	8.50%
Blue Lake	8.75%
Eureka	9.25%
Ferndale	8.50%
Fortuna**	8.50%
Humboldt County Uninc.***	7.75%
Rio Dell	8.75%
Trinidad	8.50%

\* *Proposing .75% Measure for 11-5-2024 Ballot*

\*\* *Adopted .75% Measure for 11-5-2024 Ballot*

\*\*\* *Proposing .50% Measure for 11-5-2024 Ballot*

Of the 7.25% state rate, cities and unincorporated county areas receive 1%, often referred to as the Bradley-Burns Sales Tax, which is distributed based on place of sale. Larger cities, particularly those with more expansive retail options, do well under the Bradley-Burns tax system because they draw consumers in from outside city limits. For example, Eureka is home to just 19.5% of Humboldt County’s population but receives 52.9% of the Bradley-Burns sales tax generated in Humboldt County. By comparison, Arcata houses 13.9% of the population but only receives 12.9% of the Bradley-Burns sales tax.<sup>8</sup> This means that many Arcata residents make taxable purchases outside of city limits, contributing to other local jurisdictions revenues and services.<sup>9</sup>

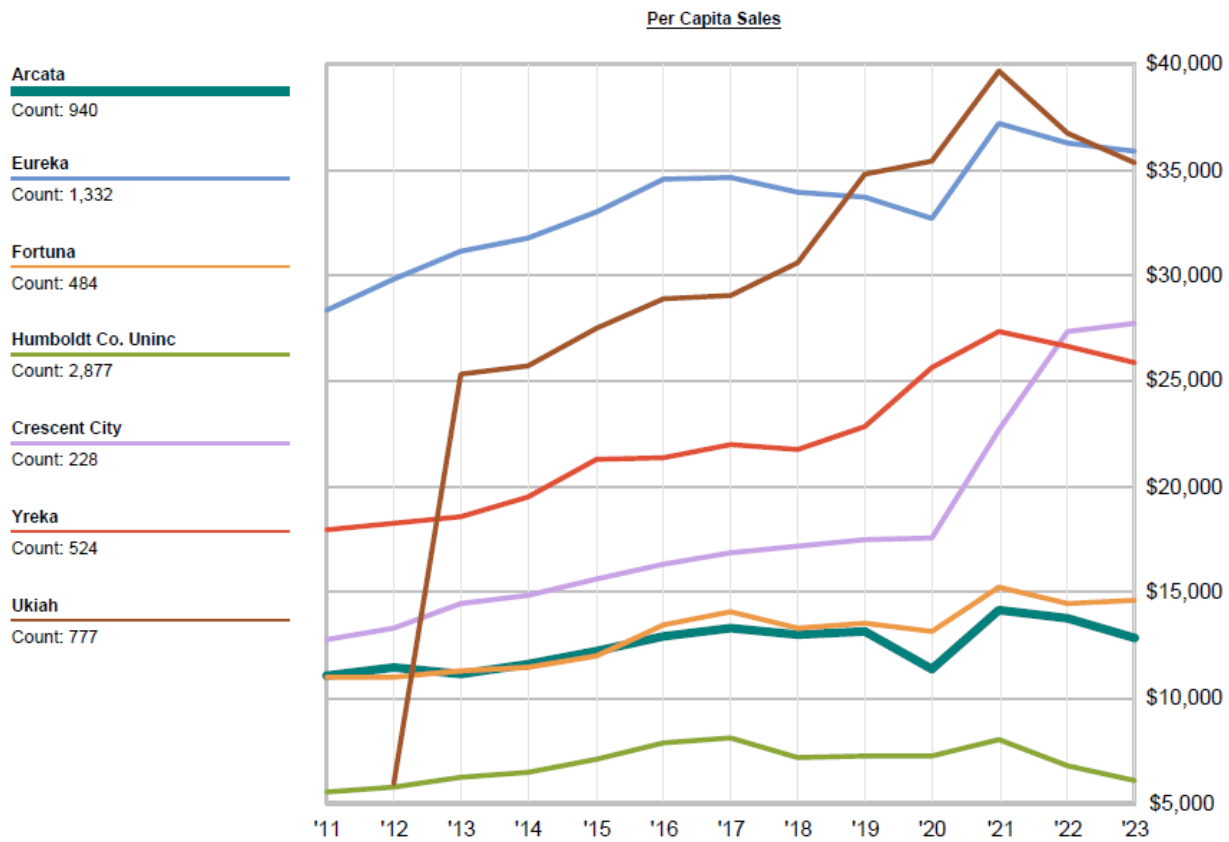
**Graph 1** below shows spending in Arcata per capita (based on location of sale) compared to other jurisdictions in Humboldt County and similarly sized cities in northern California. In recent years, Arcata’s per capital spending only exceeded that in unincorporated Humboldt County and was below all other similarly situated jurisdictions. Placing those other cities, in particular Eureka, at a fiscal advantage and Arcata at a fiscal disadvantage in receiving revenue to provide its residents and businesses municipal services.<sup>10</sup>

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<sup>8</sup> Based on Sales Tax Data for 4<sup>th</sup> Quarter of 2023 as reported by HdL Companies and population projections from the CA Department of Finance (May 2023).

<sup>9</sup> There is an argument for economic development efforts is to retain and increase tax dollars within the City of Arcata.

<sup>10</sup> In addition to collecting tax on purchases made in Eureka, Eureka’s TUT rate is 1.5% versus Arcata’s .75%.



Based on surplus/gap analysis provided by the City’s sales tax consultant HdL Companies, Arcata’s casual dining businesses provide the greatest per capita (\$806) surplus but discount department stores represent the largest deficit (\$1,352). Based on ranking by a marketing website, the top discount department stores in 2024 (in order) are: 1. Amazon, 2. Walmart, 3. Costco Wholesale, 4. Alibaba.com, 5. HomeGoods, 6. T.J. Maxx, 7. Target, 8. ALDI, 9. Dollar General, and 10. The Dollar Tree.<sup>11</sup>

Unlike the Bradley-Burns portion of the state sales tax, locally approved Transactions and Use Tax (TUT) is collected based on place of use, not place of sale. This means that products delivered to or registered in Arcata will pay the Arcata TUT. As a result, voter-approved Arcata TUT returns a greater relative percent of revenue to Arcata, as illustrated in Chart 3 below.

<sup>11</sup>Source: <https://www.marketing91.com/top-10-discount-stores/>

**Chart 3 – 1% Bradley-Burns Sales Tax versus .75% Transaction and Use Tax Receipts**

Major Industry Groups	Total 2023		
	Bradley Burns Sales/Use Tax	Transactions and Use Tax (TUT)	Ratio
Autos and Transportation	\$ 88,462	\$ 303,389	343.0%
Building and Construction	440,461	415,374	94.3%
Business and Industry	249,138	454,511	182.4%
Food and Drug	403,788	294,691	73.0%
Fuel and Service Stations	345,573	296,425	85.8%
General Consumer Goods	285,925	501,597	175.4%
Restaurants and Hotels	586,581	441,650	75.3%
Transfers & Unidentified	2,187	36,776	
<b>Total All Businesses</b>	<b>\$ 2,402,115</b>	<b>\$ 2,744,413</b>	<b>114.2%</b>
State and County Pools	575,518	-	
<b>Gross Receipts</b>	<b>\$ 2,977,633</b>	<b>\$ 2,744,413</b>	<b>92.2%</b>

Any Arcata industry group in which the Bradley-Burns to TUT Ratio exceeds 75%, proportionally collects more TUT revenue than the State Bradley-Burns Sales Tax per dollar spent. If the collection methodologies were the same, the City’s .75% TUT should only collect 75% of the 1% Bradley Burns Sales Tax Gross Receipts - not the more than 92% that it does.

Proposed Sales Tax Measure

Resolution No. 234-52 incorporates the Arcata City Voter’s priorities and directs placement of the ballot measure for three-fourth a cent increase in the general purposes TUT on the General Election to be held on Tuesday, November 5, 2024.

<b>THE ARCATA SALES TAX MEASURE</b>	
<p><b>Arcata Essential Services Measure</b>  <b>To maintain and improve Arcata’s essential city services and facilities, such as</b>                      emergency, disaster and climate change preparedness and response, services addressing homelessness and its impacts to the city, clinical mental health response to people in crisis, youth diversion counselor programs, sidewalks, bike lanes, transit, roads and trails, recreation and local parks, and other vital city programs</p>	YES
<p>shall the City of Arcata enact a measure, by adopting a 3/4 cent sales tax, for general government purposes, providing approximately \$2.6 million annually until ended by voters, requiring public spending disclosure, citizens' oversight, annual audits, and all funds used locally?</p>	NO

Attached to Resolution No. 234-52, is exhibit “A”, which is the Ordinance setting forth the additional language to incorporate into the Arcata Municipal Code, if the City of Arcata voters approve the TUT increase by a majority (50% + 1) on November 5, 2024.

**BUDGET/FISCAL IMPACT:**

The estimated cost of placing a tax measure on the November 5, 2024, ballot is:

<b>Account</b>	<b>Description</b>	<b>Amount</b>
101-10-05-52501	Additional Cost of Placing Measure on the General Election Ballot	\$5,000
101-10-09-51771	Legal Counsel Review	\$2,500
101-10-05-52501	Public Notices, Forms, Misc. Expenditures	\$800
	<b>Total Estimated Costs</b>	<b>\$8,300</b>

A three-fourth of a percent (.75%) TUT is estimated to generate \$2.6 million annually in General Fund revenue.

**ATTACHMENTS:**

- A. Resolution No. 234-52 (DOCX)
- B. Attachment "A" Ordinance No. 1570 (DOCX)
- C. California County and City Sales and Use Tax Rates (PDF)