

ADMINISTRATIVE SERVICES DEPARTMENT

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CITY COUNCIL STAFF REPORT

Meeting: June 16, 2020

Subject

Tax Measure Polling and Strategy for November 2020 ballot

Recommended Action

- 1. Provide direction to move forward with a polling and strategy firm to explore transient occupancy tax (TOT) measure for the November 2020 ballot:
- 2. Approve a budget adjustment of \$55,000 to retain polling and strategy firm.

Discussion

Since the Great Recession, the City of Cupertino has thrived through the longest recovery/expansionary period in United States history. During that time, the City experienced increases in property tax rates from 6.25% to 7.0%, increases in sales tax through localization agreements with Apple, Inc., increases in transient occupancy tax rates from 10% to 12% in 2012, and significant development which further bolstered its primary revenue streams. As a result, the City has established strong reserves in addition to taking prudent steps to better position against economic downturns and long-term liabilities.

The strength of the City's revenue streams has enabled the City to fund capital projects with excess fund balance from the General Fund. Since FY 2015-16, the General Fund has transferred a total of \$45,791,725 to fund various capital projects. However, it has become increasingly difficult to fund significant capital improvement projects while simultaneously funding maintenance and repair of the City's aging buildings and infrastructure due to rising costs. With over \$300 million in unfunded projects Citywide as of the FY 19-20 Capital Improvement Program Budget, capital project funding continues to be one of our more significant challenges.

With the COVID-19 outbreak commencing in 2020, the City will experience steep, material declines in revenue streams, and will face an unprecedented level of uncertainty surrounding the extent and magnitude of adverse impacts related to COVID-19It is essential to ensure the City's strong fiscal foundation is sustained through the COVID-19 pandemic.

Of the various potential tax measures that could be considered, only the TOT measure is recommended. If Council decides to move forward with a TOT measure for the November 2020 ballot, it is recommended that the City conduct a polling survey of Cupertino voters. The purpose of this opinion research is to provide statistically valid quantitative data regarding attitudes and opinions of Cupertino voters, and to gauge support for a revenue measure that might be on the November 2020 ballot.

Opinion research firms work in collaboration with the City and its selected strategy firm, as well as other key stakeholders, to design a scientifically sound survey instrument to ensure confidence in survey results and to help establish consensus in making important strategic decisions. Based on research results staff have identified qualified opinion research and strategy firms in the region and State. Should City Council decide to move forward, the proposed timeline for a November 2020 revenue measure would be as follows:

- ➤ Week of June 1st Contract award
- ➤ Week of June 1st Project kick-off meeting to identify key project goals and objectives; draft questionnaire
- ➤ Week of June 8th Finalize questionnaire, purchase sample of likely voters, conduct interviews
- ➤ Week of June 23rd Process and weight data; provide preliminary survey results
- ➤ July 7th Presentation of final survey report to City Council. Decision to move forward with one or more potential measures is made
- ➤ July to mid-August Public information disseminated explaining why City Council is considering or has voted to place a revenue measure on the ballot
- ➤ July 21st Last regularly scheduled meeting of City Council for Introduction/First Reading of revenue measure ordinance
- ➤ August 4th Last regularly scheduled meeting of City Council for Second Reading/Adoption of revenue measure ordinance and approval of resolution calling the election
- August 7th Deadline for City submission of ballot measure to Registrar of Voters
- ➤ August 18th Deadline for City's submittal of impartial analysis of ballot measure
- ➤ November 3rd Election Day

On April 2, 2019, City staff and Urban Futures Inc. (UFI) presented the City's updated financial forecast and capital financing options to City Council. In addition to establishing and implementing a baseline forecast, UFI presented various General Fund revenue options, more specifically, local tax measures as discussed further below:

Transient Occupancy Tax (TOT)

This tax is primarily paid by non-residents, but it can impact future hotel growth if disproportionate. The City's current TOT rate is 12% (effective 2011); a 2% increase to 14% would result in an estimated additional \$1.7 million annually. In 2018, 43 TOT measurers were on the ballot with 38 or 88% being approved by voters. The trendline for TOT growth is more positive than other taxes; however, total revenue generation is less in comparison with a sales tax or parcel tax measure. It would require a majority vote for general tax and two-thirds vote for special tax.

City/Area	Rate*
Santa Clara County	
Santa Clara	9.5%
Los Gatos, Mountain View, San Jose, Saratoga	10.0%
Los Altos, Morgan Hill	11.0%
Campbell, Sunnyvale	12.0 - 12.5%
Los Altos, Milpitas	14.0%
Palo Alto	15.5%
San Mateo County	
Belmont, Brisbane, Burlingame, Colma, East Palo Alto, Foster City, Menlo Park, Millbrae, Pacifica, Redwood City, San Bruno, San Mateo	12.0%
Daly City	13.0%
San Carlos, South SF	14.0%
San Francisco	14.0%

Pros:

- o Paid by non-residents
- Recent TOT measures in 2016 and 2018 have high approval rates *61% and 88% respectively)
- Trendline points to stronger growth in TOT revenue compared to other local taxes

Cons:

- Total revenue from 1% to 3% increase in TOT may not be sufficient to help
 General Fund avoid operating deficits in long-term
- City is currently in middle of regional TOT rates at 12% but adding 3% would place it second only to Palo Alto for the region (and make it one of the highest in the State).

If Council chooses to proceed with a tax measure on the 2020 ballot, a TOT increase is the type of measure that is recommended.

Transaction and use tax (TUT)

This measure is functionally similar to statewide sales taxes and would require 2/3 vote for a special tax or majority vote for a general tax. If approved, the tax would generate an estimated additional \$4 million annually. If approved on the November ballot, the City would start receiving the additional revenue two quarters after the election. In the 2018 election, 84% of sales tax measures (69 in total) were approved.

City/Area	Rate*
Santa Clara Countywide	9.0%
Campbell	9.25%
Los Gatos	9.125%
San Jose	9.25%
San Mateo Countywide	8.75%
Belmont	9.25%
Burlingame	9.0%
East Palo Alto	9.25%
Redwood City	9.25%
San Mateo	9.0%
South San Francisco	9.25%
San Francisco	8.50%
Alameda Countywide	9.25%

Pros:

- 0.25% maximum increase keeps City fairly proportional to surrounding areas
- Consumption tax burden spread across residents, businesses, and visitors
- Sales tax revenue growth continue to be strong in the City
- o Allows for local control of remaining 0.25% up to the sales tax cap

Cons:

- Sales tax strongly correlated with overall economic trends (1% decline in GDP = 0.90% decline in sales tax)
- TUT not applicable to business to business sales when purchaser is located outside of the City
- o Affects up to 60% of sales tax base (does not include tax sharing agreements)

Parcel Tax

A parcel tax is a non-ad valorem (non-value based) tax on parcels of property. Either a flat rate per parcel or a variable rate depending on the size, use, or number of units on the parcel can be used; however, it is used most often by school districts for capital financing. The most common methodology for assessing is by using a flat rate per parcel. Inflationary indices can be applied to ensure that the revenue stream keeps pace with rising costs.

Flat Rate per Parcel by Type of Use							
Parcel Type	# of Parcels	Per Parcel Tax	Annual Revs. (est.)				
Residential	15,838	\$200	\$3.2 million				
Multi-Family	79	\$400	\$31,000				
Commercial/Office/Ind.	473	\$600	\$284,000				
		Total	\$3.5 million				

Variable Rate per SF by Type of Use								
Parcel Type (avg. annual cost)	Total Acres	Per SF Tax Rate	Annual Revs. (est.)					
SFR - 5,000 sf & condos (\$72)	159	\$0.015	\$104,000					
SFR - 5,000 to 10,000 sf (\$111)	1,510	££	\$987,000					
SFR – 10,000 to 17,500 sf (\$170)	420	66	\$274,000					
SFR - Over 17,500 sf (\$418)	460	66	\$301,000					
Multi-Family (\$3,600)	79	\$0.05	\$130,680					
Commercial/Office/Ind. (\$3,700)	473	\$0.05	\$1.8 million					
		Total	\$3.6 million					

Pros:

- The City may define specific purposes for revenues, subject to two-thirds voter approval;
- Tax revenue is not impacted by overall economic trends (non-ad valorem), plus inflationary indices help keep pace with rising costs; and,
- Flexibility is in designing the structure allocation between types of property uses and applicable tax rates.

Cons:

- Requires two-thirds approval of electorate usually dependent on strength on community support for specific purpose of tax;
- Flat parcel tax often considered very regressive; and
- Amount of tax required to generate \$3-\$4 million may require per parcel levy significantly greater than most other parcel taxes approved in the region

Utility Users Tax (UUT)

The City's Current UUT rate is 2.4%. For each additional 100 basis points, an additional \$1.3 million in revenue is estimated to be received. For example, a UUT rate of 4% would generate approximately \$2.1 million in additional revenue and a UUT rate of 5% would generate \$3.5 million. The City's UUT modernized in 2009 to ensure application to changing telecommunications services. The trendline for UUT growth is flat with potential for slight negative growth (due to water conservation, solar generation, etc.). However, volatility is less than other economic-sensitive revenue streams.

Pros:

- o Can establish different rates for residential vs. commercial
- o Less volatility than other economic-sensitive revenues
- City built-out with largely white-collar industry so not as strong a deterrent to business compared to other regions

Cons:

- Baseline UUT revenues are forecasted to be flat or decline slightly as they are less likely to keep pace with key expense drivers
- o Historic voter approval rates are lower (60%), but advisory measure may help
- Doubling of existing rate to 5.0% puts City at top of range in region (equal with Daly City, Palo Alto, Redwood City, San Jose)

Business Tax (Head Tax)

On July 31, 2018, City Council received a presentation from City staff on a proposed business tax which would be used to fund priorities such as infrastructure to reduce traffic congestion. The proposed employee rate models were then estimated to be:

Model 1: Per Employee Rates Up to \$325											
		% of	Estimated								
Employee	# of	Businesses	#	Base	Emp	Employee				Effective	
Range	Businesses	in Tier	Employees	Rate	F	Rate		Total BL Tax		Tax Rate	
1-9	3,128	89.4%	3,400	\$150	\$	-	\$	469,200			
10-49	300	8.6%	4,000	\$250	\$	-	\$	75,000			
50-99	40	1.1%	2,400	\$500	\$	-	\$	20,000			
100-249	25	0.7%	3,300	\$500	\$	50	\$	53,750	\$	16	
250-499	5	0.1%	1,300	\$500	\$	100	\$	45,250	\$	35	
500-999	1	0.0%	600	\$500	\$	175	\$	50,525	\$	84	
1,000-4,999		0.0%		\$500	\$	250	\$	-			
5,000+	1	0.0%	24,000	\$500	\$	325	\$	7,295,250	\$	304	
Total	3,500	100.0%	39,000				\$	8,008,975			

Model 2: Per Employee Rates Up to \$425											
		% of	Estimated								
Employee	# of	Businesses	#	Base	Em	Employee				Effective	
Range	Businesses	in Tier	Employees	Rate		Rate		Rate Total BL Tax		Tax Rate	
1-9	3,128	89.4%	3,400	\$150	\$	-	\$	469,200			
10-49	300	8.6%	4,000	\$500	\$	-	\$	150,000			
50-99	40	1.1%	2,400	\$500	\$	-	\$	20,000			
100-249	25	0.7%	3,300	\$500	\$	50	\$	53,750	\$	16	
250-499	5	0.1%	1,300	\$500	\$	100	\$	45,250	\$	35	
500-999	1	0.0%	600	\$500	\$	200	\$	53,050	\$	88	
1,000-4,999		0.0%		\$500	\$	300	\$	-			
5,000+	1	0.0%	24,000	\$500	\$	425	\$	9,407,775	\$	392	
Total	3,500	100.0%	39,000				\$1	0,199,025			

With the utilization of a third-party polling firm, staff conducted three scientific polls on this matter. In May 2018, nearly 71% of likely November 2018 voters said they would support an increase in the business license tax with large businesses paying more than small businesses. The poll also showed 63% support for an increase in the business license tax for general purposes. In July 2018, support for the measure dropped to 51% in poll and 55% in another poll.

Pros:

- Business tax would generate the largest amount of annual revenue for the City (\$8-\$10 million depending on structure)
- Tax revenue is not impacted by overall economic trends (non-ad valorem), plus inflationary indices help keep pace with rising costs; and,

Cons:

- ➤ Generating the estimated \$8-\$10 million in annual revenue would require a tiered application to businesses in the City
- ➤ The business tax has been argued to be a tax on jobs that could have limiting impacts on the prospect of jobs in a respective community.

Sustainability Impact

No sustainability impact.

Fiscal Impact

The estimated cost for retaining an opinion research and strategist firm would range between \$50,000 and \$70,000. Assuming historical occupancy rates, the fiscal impact of a transient occupancy tax increase from 12% to 14% would generate an estimated \$1.7 million in additional annual revenue for the City.

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