



TOWN OF LOS GATOS
FINANCE COMMISSION REPORT

MEETING DATE: 07/12/2021

ITEM NO: 4

DATE: July 8, 2021
TO: Finance Commission
FROM: Laurel Prevetti, Town Manager
SUBJECT: Discuss and Recommend Options to Pursue for a Town Council Strategic Priority – “Explore New Revenue Opportunities”

RECOMMENDATION:

Discuss and recommend options to pursue for a Town Council Strategic Priority – “Explore New Revenue Opportunities.”

BACKGROUND:

In September 2015, the Town Council received a report titled “Long Range Capital Funding Options”. The report identified the historical use of year-end General Fund savings as the Town’s primary mechanism to fund the Town’s capital needs in the past. In addition, the report discussed the annual uncertainty of excess General Fund dollars as a challenge to the Town’s ability to plan and deliver needed maintenance and capital improvements. The report identified opportunities for new revenues that could be directed specifically to the Town’s capital needs. The revenue options were organized into two categories: (1) Council authority to approve and (2) subject to voter approval.

Since issuance of that initial staff report, the Town Council has acted on several revenue enhancement options including the following:

- November 2016 Measure T increased the Transient Occupancy Tax (TOT) from 10 percent to 12 percent. The 2% increase raises approximately \$400,000 annually in additional revenue.
- November 2018 Measure G creates a 1/8 cent dedicated district sales tax for a 20-year period. The adoption of the dedicated tax provides approximately \$1,000,000 annually in additional revenue.

PREPARED BY: Arn Andrews
Assistant Town Manager

Reviewed by: Town Manager, Town Attorney, and Finance Director

BACKGROUND (continued):

- In February 2019 Council approved an Ordinance allowing regulated short-term rentals subject to TOT. Approximately \$80,000 of additional TOT is collected annually.
- In June 2019 Council voted to annex 24 unincorporated County pockets. This action results in approximately \$1,000,000 in property taxes remaining in the Town instead of being diverted to the County.
- In January 2021, Council directed the Town Attorney to explore and examine the potential of updating the Town’s cannabis regulations to allow commercial cannabis businesses and the fiscal tax impact associated therewith.
- The Town submitted the final allowable increase in Refuse Vehicle Impact Fee to West Valley Collection and Recycling in FY 2021.

DISCUSSION:

With increasing operating costs and growing infrastructure needs, the Town Council identified “Explore New Revenue Opportunities” as a FY 2021-2023 Strategic Priority. During the recent budget deliberations of May 18, the Council reconfirmed their commitment to establish new revenues for capital needs and maintaining the high level of operating services. Council directed the Finance Commission to review and prepare a list of potential revenue options for Council and public consideration. To facilitate that review and recommendation, this report organizes revenue options into two categories: (1) Council authority to approve and (2) subject to voter approval.

Revenue Options under the Council’s Approval Authority

Staff has identified seven revenue options that Council has authority to enact by majority vote after due notice:

- Sale or Lease of Property
- Taxation of Short-Term Vacation Rentals
- Business License Tax Audit and Amnesty Program
- Commercial Property Business License
- Sidewalk Repair Cost Sharing
- Commercial Cannabis Businesses
- Full Cost Recovery for Town Services

DISCUSSION (continued):

Sale or Lease of Property

To date, the Town has pursued a property strategy which focuses on finding long-term solutions for the disposition of Town-owned properties either through pursuit of public purpose, monetization, or a hybrid of both. Following are dispositions approved by the Town Council to date:

- October 2018 entered into an Exclusive Negotiating Agreement with Sarah Chaffin for the siting and development of affordable (teacher) housing at 20 Dittos Lane – Public Purpose
- March 2019 entered into an Exclusive Negotiating Agreement with Imwalle Asset Management for 4 Tait Avenue and Forbes Mill - Monetization/Public Purpose
- May 2019 sale of 148000 Winchester Blvd to Santa Clara County Fire District (“County Fire”) for \$1.9 million – Monetization/Public Purpose
- April 2020 sale of 14850 Winchester Blvd to Santa Clara County Fire District (“County Fire”) for \$1.2 million – Monetization/Public Purpose

There are two remaining Town owned properties that have not reached disposition status at this time.

- **224 West Main** - On October 12, 2012, the Oversight Board for the Successor Agency of the Redevelopment Agency of the Town of Los Gatos approved the transfer of housing assets to the Town. In addition to the Dittos Lane property, the property at 224 West Main was transferred to the Town for the purpose of affordable housing with commercial space. The asset was originally purchased in 2009 by the former Redevelopment Agency and was transferred to the Town at a valuation of \$1,489,778. The Town Attorney has concluded that the Town either has to reimburse the Town’s Below Market Price Housing Fund the \$1,489,778 or the property is obligated to provide 6 low and moderate income housing units.
- **4 New York Avenue** – On September 13, 2016, the Town Council declared 4 New York Avenue as surplus property. The Venue property consists of approximately 75,000 square feet, or 1.71 acres. The land is currently zoned Resource Conservation. The subject property is currently zoned Resource Conservation. Per Council direction, negotiations continue with the Los Gatos High School.

Taxation of Short-Term Vacation Rentals

As previously mentioned, the Town levies a 12% transient occupancy tax (TOT) on all hotel and motel rooms within the municipal limits of Los Gatos. The 12% rate has been in effect since January 1, 2017 after the voters approved a ballot measure to increase the TOT from 10% to

DISCUSSION (continued):

12% at the November 8, 2016 election. Since 2019 this rate is also applied to short-term vacation rentals.

Since 2016, TOT has increased in other nearby communities (e.g., Palo Alto is now at 15.5%) and the Town could ask the voters to consider another increase as discussed in more detail below.

Business License Tax Audit and Amnesty Program

All businesses operating within the Town of Los Gatos are required to pay a business license tax. There are approximately 3,200 businesses operating within the Town. In 2015, staff audited 23% of businesses to assess the Town's exposure to non-licensing. Based on this audit, staff found that approximately 8% of businesses are operating without a valid business license. Since business license tax varies depending on the classification of the business, (i.e. retail, service, professional, etc.), it is difficult to make assumptions regarding potential lost revenue from non-licensed businesses.

The Town could elect to initiate a Business License Amnesty program, in which staff would mail notification letters to all Town addresses outlining the requirement for obtaining a business license and offering a penalty free period of time for anybody with past tax due to the Town to bring their license current without penalty. This would generate one-time money as well as on-going revenue as the business would then be captured in the Town's database for future collection.

Amnesty programs often work best when combined with a business license audit. The audit completed during 2015 only captured businesses operating out of a business location within the Town. Home-based businesses are difficult to identify and were not part of the scope of the audit completed in 2015. There are a variety of independent companies that perform contract business license audit services.

Commercial Property (Landlord) Business License

In the enforcement of the Town's business license tax program, commercial property owners are not required to pay a business license tax since the tenant of the commercial property is required to have a business license for their business operating out of the commercial property. Taxing the commercial property owner could be considered a double tax of the property.

DISCUSSION (continued):

Sidewalk Repair Cost Sharing

The Town of Los Gatos currently operates a sidewalk replacement service to residents at no cost. Some municipalities in Santa Clara County (SCC) offer these programs with a cost-sharing component. For example, the City of San Jose requires residents to pay the full cost of sidewalk replacement.

The Town currently expends approximately \$300,000 annually for residential sidewalk repairs. With residents sharing 50% of the costs, the Town could receive an additional \$150,000 in revenue annually. Cost-sharing programs typically require significant administrative support. Therefore, a 50% cost sharing agreement for residential sidewalk replacement would likely result in revenues lower than 50%.

Commercial Cannabis Businesses

Medical cannabis use has been legal in California since 1996. On November 9, 2016, adult recreational use of cannabis by persons age 21 or over became legal in California. In June 2017, California enacted the Medicinal and Adult Use Cannabis Regulation and Safety Act (MAUCRSA), which consolidated the state regulatory and licensing framework for medical and recreational adult-use cannabis. Cities still retain full regulatory authority over all commercial cannabis businesses (both medical and recreational adult use).

Effective January 1, 2018, a 15% State excise tax became imposed upon retail purchasers of all cannabis and cannabis products. On top of this tax rate, cannabis sales are subject to local sales tax. In addition to the excise and sales tax, local taxation is possible but would require the approval of Town of Los Gatos voters at a general election unless it is an agreed upon term of conditions of approval. A preliminary analysis estimates that a local tax rate of between 4% and 6% could potentially generate between approximately \$800,000 to \$1.5 Million in revenue for the Town.

The Town Attorney has begun his analysis, will be undergoing an outreach effort to determine community interest in this option, and will be bringing a report to the Finance Commission in early fall.

Full Fee Cost Recovery for Town Services

The Town's financial policies require that certain fees, rates, and charges for services be maintained to allow for cost recovery based on the actual cost to provide Town services. "Fee" activities are services and functions provided by the Town to individuals who receive some

DISCUSSION (continued):

direct material benefit above and beyond services offered to residents at general taxpayer expense.

The Town periodically reviews the cost of providing such services and recommends appropriate increases in fees when supported by actual cost data. The Town's last comprehensive cost allocation and user fee study concluded in FY 2018/19 and the Council approved modifications that were incorporated in the FY 19/20 Fee and Fine Schedule. Staff prepared an annual review of the fees during Fiscal Year 2020/21, but due to the COVID-19 pandemic no fee discussion and adjustments have occurred since the adoption of the FY 2019/20 Fee and Fine Schedule. As the economy recovers, the Council may consider modifying the schedule to include Consumer Price Index increases (see separate report).

Revenue Options Subject to Voter Approval

Local agencies may impose taxes, subject to voter approval, using a variety of methods. Pursuant to Proposition 218, these taxes are classified as either "general" or "special."

Whether the ballot measure requires a simple majority (50% + 1 vote) or a super majority (two-thirds of those voting in the affirmative) depends upon the ballot language and whether the question is placed upon the ballot as a general tax increase or a special tax increase

A "general tax" may be used for any public purpose — the funds are fully discretionary and may be deposited into the General Fund. A majority vote (50%+1) of the electorate is required to impose, increase, or extend a general tax.

A "special tax" is a tax imposed for a specific purpose. For example, some cities dedicate tax revenues for the payment of law enforcement or street maintenance costs rather than using the taxes for the general operations of government. A two-thirds majority of voters is required to impose, increase, or extend a tax for a specific purpose.

General taxes may only be put on the ballot at the same general election when the Town Council election is held, unless the Council unanimously finds that there is an urgent need to impose the tax measure. Upon such unanimous declaration, the general tax measure may be put before the voters at a special election. Special taxes may be placed before the electorate at any time, either during a general election or in a special election.

The following six new revenue options, all requiring voter approval, have been identified for consideration:

DISCUSSION (continued):

- Assessment Districts
- Utility User Tax (UUT)
- Increased Transient Occupancy Tax (TOT)
- Increased Sales Tax
- Parcel Tax – General or Special
- Commercial Cannabis Businesses

Assessment Districts

An Assessment District is a special district that includes property that will receive direct benefit from new public improvements or from the maintenance of existing public improvements. The most common types of assessments are for roads, storm water, parks, landscaping, and street lighting. Formation of an Assessment District requires voter approval, which must be done in the form of a mailed ballot. Assessment Districts require that at least as many ballots (as weighed by the amount of the assessment against the parcel submitting the ballot) are returned in favor of the assessment as are returned in opposition to the assessment.

Each property is assessed a certain amount based on the percentage of benefit received by the property. Factors that determine the amount of benefit received may include the size of the lot or the proximity to the improvement being financed. The collection of the assessment charges occurs through County property tax collections and is earmarked for the special assessment district as defined. Unless specified by a sunset clause, the collection will continue into the future at a minimum growth allowable by Proposition 13. A CPI (consumer price index) may also be added to the collection so as to keep revenues growing at a rate equal to expenditures.

Utility User Tax (UUT)

The Utility User Tax (UUT) may be imposed by a county/city/town on the consumption of utility services, including (but not limited to) electricity, gas, water, sewer, telephone (including cell phone and long distance), sanitation and cable television. The tax is collected by the utility as part of its regular billing and then remitted to the Town. The tax rate is typically defined by the voter referendum used to authorize the tax. Statewide, approximately 158 cities and 4 counties have adopted UUTs. The most common rate is 5%, applied broadly among many types of utilities, with the average rate being 5.4%. Most large cities have UUTs, meaning roughly half of California residents and businesses pay a utility user tax.

Currently, all UUTs have been adopted as general taxes with the exception of Desert Hot Springs (safety) and Mammoth Lakes (mobility/recreation/Arts and Culture).

DISCUSSION (continued):

The Town of Los Gatos does not have any UUT's; however, other cities in Santa Clara County do impose UUTs. Staff's survey of the other 14 cities in the County found that:

- **Telephone (Intra and Inter State) UUT** - Imposed by Cupertino, Los Altos, Palo Alto, San Jose, Gilroy, and Mountain View at rates ranging between 2.4% in Cupertino to 4.75% in Palo Alto.
- **Electricity UUT** - Imposed by Cupertino, Los Altos, Palo Alto, San Jose, Gilroy, Mountain View and Sunnyvale at rates ranging between 2.0% in Sunnyvale to 5.0% in Palo Alto, San Jose, and Gilroy.
- **Gas UUT** - Imposed by Cupertino, Los Altos, Palo Alto, Gilroy, Mountain View, San Jose, and Sunnyvale at rates ranging between 2.0% in Sunnyvale to 5.0% in Palo Alto, San Jose, and Gilroy.
- **CATV UUT** - Imposed by, Los Altos, and Gilroy at rates ranging between 2.4% in Cupertino to 4.5% in Gilroy.
- **Water UUT** - Imposed by, Los Altos, Palo Alto, and San Jose at rates ranging between 2.4% in Cupertino to 5.0% in both Palo Alto and San Jose.

Increased Transient Occupancy Tax (TOT)

As previously mentioned, the Town levies a 12% transient occupancy tax (TOT) on all hotel and motel rooms within the municipal limits of Los Gatos. The 12% rate has been in effect since January 1, 2017 after the voters approved a ballot measure to increase the TOT from 10% to 12% at the November 8, 2016 election. This rate is also applied to short-term vacation rentals.

Since 2016, TOT has increased in other nearby communities (e.g., Palo Alto is now at 15.5%) and the Town could ask the voters to consider another increase.

Increased Sales Tax

The Town currently receives 1.125 cent for every 9.125 cents of sales tax paid per dollar on retail sales and taxable services transacted within Los Gatos. As previously mentioned, an 1/8 cent dedicated district sales tax for a 20-year period was approved by voters in November 2018 and provides approximately \$1,000,000 annually in additional revenue. Under State law, the Town is currently eligible to assess an additional 1/2 cent as a special district tax.

Parcel Tax - General or Special

A parcel tax is a form of special property tax based on the characteristics of a parcel, or unit of property, rather than a rate based on the assessed value of the property. A parcel tax can be based on either a flat per-parcel rate or a variable rate depending on the size, use, or number of

DISCUSSION (continued):

units on the parcel. There are approximately 10,000 taxable parcels in the Town. Therefore a \$100 parcel tax would generate approximately \$1.0 million in new revenue which could be designated for capital projects. Parcel tax revenues can be used for any type of governmental spending.

A parcel tax is considered a qualified special tax in California and may be imposed by a local unit of government, such as a city, county, school district, or special district. Special taxes are permitted by the California Constitution, and they require a two-thirds (66.67 percent) supermajority vote for approval. Elections to vote on parcel tax measures must take place on established election dates. In even-numbered years, these elections dates are in March, April, and November. In odd-numbered years, the elections are in March, June, and November. Notice of a parcel tax election must be given at least 90 days in advance of the election date.

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The Town Attorney has begun his analysis, will be undergoing an outreach effort to determine community interest in this option, and will be bringing a report to the Finance Commission in early fall.

CONCLUSION:

The Commission should discuss potential revenue options and determine which options should be recommended to the Town Council for further review/analysis.