

TOWN OF LOS GATOS MEMORANDUM

TO: Laurel Prevetti, Town Manager, Town of Los Gatos

FROM: Nick Dayhoff, Senior Consultant

DATE: December 14, 2023

SUBJECT: Revenue Modeling Scenarios

Purpose

The Town of Los Gatos (the “Town”) has requested a comprehensive evaluation of options to increase revenue to address the Town’s forecasted budget deficits in the near term. This evaluation includes modeling for increases to sales tax and transient occupancy tax (“TOT”) rates, and a limited model for a new utility user tax (“UUT”) and a new parcel tax. This Memorandum summarizes additional revenues that could be generated via a new parcel tax based on various revenue targets, the estimated revenue generated by potential increases to the Town’s sales tax and TOT rates, and the estimated revenue generated by the implementation of a UUT.

Projected Budget Deficits

According to the Town’s Operating and Capital Summary Budget for Fiscal Year 2023/24, the following table shows the forecasted budget deficits for Fiscal Years 2025/26 through 2028/29:

Item	FY	FY	FY	FY
	2025/26	2026/27	2027/28	2028/29
Forecasted Surplus/(Deficit), in Millions	(\$2.8)	(\$3.1)	(\$3.3)	(\$3.8)

Non-Viable and Not-Recommended Revenue Options

Property Transfer Tax Increase

Only Charter cities can increase the property transfer tax rate above the general law maximum of \$0.55 per \$1,000 of value (city rate). The Town is not a Charter city.

Limited UUT for Cable, Gas, and Electric Utilities

A UUT may be imposed by the 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 Town does not currently levy UUTs, so modeling what the potential revenues might be from a new UUT relies on the limited amount of information received from the Town, including historical franchise fee collections from its cable, electric, and gas franchises. Since any UUT would be based upon the gross receipts of each utility, NBS has had to estimate the gross receipts of the gas, electric, and cable utilities based on forecasted franchise fee collections and franchise fee rates for the Town's cable, electric, and gas franchises.

The Town does not collect franchise fees for the water, sewer, or telephone utilities, so we cannot estimate what the gross receipts of those utilities might be. As such, we have not included these utilities in our estimate of potential UUT revenue. In addition, NBS is not including a UUT on the Town's garbage utility as part of this analysis, as the contract between the hauler and the Town is currently being negotiated and the service may no longer be categorized as a "Franchise" moving forward.

According to the Town, the following table shows the forecasted cable, electric, and gas franchise fee collections for Fiscal Years 2025/26 through 2028/29:

Title	2025/26	2026/27	2027/28	2028/29
CABLE FRANCHISE FEE	\$ 530,450	\$ 546,360	\$ 562,750	\$ 579,630
PG&E FRANCHISE FEE	441,830	455,080	468,730	482,790
TOTAL	\$ 972,280	\$ 1,001,440	\$ 1,031,480	\$ 1,062,420

From here, we can estimate what the gross receipts of the cable and gas/electric utility are, as the cable franchise fee is 5.00% of gross revenues, and the gas/electric franchise fee is 2.00% of gross revenues.

Title	2025/26	2026/27	2027/28	2028/29
CABLE @ 5% FF	\$ 10,609,000	\$ 10,927,200	\$ 11,255,000	\$ 11,592,600
PG&E @ 2% FF	22,091,500	22,754,000	23,436,500	24,139,500
TOTAL	\$ 32,700,500	\$ 33,681,200	\$ 34,691,500	\$ 35,732,100

The following table shows the potential revenue generated via various UUT rates for the cable, gas, and electric utilities for Fiscal Years 2025/26 through 2028/29:

Potential UUT	Potential New Total UUT %	Additional Revenue 2025/26 Projected	Additional Revenue 2026/27 Projected	Additional Revenue 2027/28 Projected	Additional Revenue 2028/29 Projected
1.00%	1.00%	\$ 327,005	\$ 336,812	\$ 346,915	\$ 357,321
2.00%	2.00%	654,010	673,624	693,830	714,642
3.00%	3.00%	981,015	1,010,436	1,040,745	1,071,963
4.00%	4.00%	1,308,020	1,347,248	1,387,660	1,429,284
5.00%	5.00%	1,635,025	1,684,060	1,734,575	1,786,605

The following table shows how the maximum estimated UUT revenue (5.00%) in the table above would affect the Town's forecasted deficits:

Item	FY 2025/26	FY 2026/27	FY 2027/28	FY 2028/29
Forecasted Surplus/(Deficit), in Millions	(\$2.8)	(\$3.1)	(\$3.3)	(\$3.8)
UUT Revenue @ 5.00%, in Millions	1.6	1.7	1.7	1.8
Forecasted Surplus/(Deficit), in Millions	(\$1.2)	(\$1.4)	(\$1.6)	(\$2.0)

Based on these revenue estimates, the Town would still be in deficit in the near term; however, if combined with the following other recommended revenue options, the Town could potentially close its deficit. The approval of a majority of registered voters within the Town is needed to implement a UUT. In general, obtaining voter approval for a new UUT where none existed is difficult to achieve. In addition, when Town voters were asked about a new UUT in a 2016 poll, opposition was twice that of support, with 62% opposed and 31% in favor. We see no reason why this sentiment should have changed enough since then to make a new UUT a viable option for the Town. In addition, from 2002 through 2020, 85 cities asked for voter approval of a new UUT, and just 28 (33%) were successful, even though approval required only a majority vote.

UUT for Streaming Video Services

In 2021, a judge in Los Angeles ruled that local utility laws don't cover streaming services, so imposing a UUT on streaming services may not be a viable option. NBS recommends that the Town obtain a legal opinion on this matter.

Special Assessment Districts

Several statutes authorize cities to levy assessment for specific services and facilities. General law cities considering assessments are limited to the services and facilities types listed in each statute and must comply with the substantive and procedural requirements in Article XIII D of the California Constitution, added by Proposition 218, and the Proposition 218 Omnibus Implementation Act.

The following are some of the most used authorizing statutes for assessments and the kinds of services and facilities for which they can be used:

Landscaping and Lighting Act of 1972: Authorizes assessments for such things as the installation, construction, and maintenance of landscaping; ornamentation; street lighting, including traffic signals; curbs, gutters, sidewalks, and drainage; parks and recreational facilities; community centers, auditoriums, and public performance space.

Benefit Assessment Act of 1982: Authorizes assessments for the maintenance of drainage; flood control; street lighting; and streets, roads, or highways.

Improvement Act of 1911 ("1911 Act"): Authorizes assessments for a variety of public improvements, such as streets and sidewalks, including decorative features; sewers; storm drains; lighting; pipes and hydrants for fire protection; levees and walls for the protection of streets and to prevent beach erosion or promote accretion to beaches; water supply; gas supply; bomb shelters; trees and landscaping; mooring; land

stabilization improvements. It also allows assessment revenue to be used for limited acquisition of land related to the authorized improvements.

Municipal Improvement Act of 1913 ("1913 Act"): Generally authorizes assessments for the acquisition of land and construction of a wide array of public works and improvements, including but not limited to utilities. It also allows for the financing of some improvements to private property, such as seismic strengthening and fire safety.

In calculating an assessment, a city must first determine the entire cost of the facility or service to be funded. It must then separate the benefits of the service or facility to the general public from the benefits to property owners who will be subject to the assessment. That means, in part, determining the proportionate special benefit that each parcel subject to the assessment derives from the service or facility. Finally, the assessment imposed on each parcel cannot exceed the cost of the special benefit conferred on the parcel.

An option to fund general city services via special assessment does not exist in California. In addition, assessment districts may not fund general public-safety services, as those services have been deemed to provide general benefits to entire communities, and not special benefits to certain properties.

Transient Occupancy Tax

The Town currently levies a TOT in the amount of 12% of the rent charged by the operator for the privilege of occupancy in any hotel. It's worth noting here that Palo Alto has a 15.50% TOT rate, Los Altos and Milpitas have a 14.00% TOT rate, Santa Clara, Sunnyvale, and the unincorporated areas of Santa Clara County have a 12.50% TOT rate, Campbell and Cupertino have a 12.00% TOT rate, Morgan Hill, Mountain View, San Jose and Saratoga have a 10.00% TOT rate, and Gilroy has a 9.00% TOT. Los Altos Hills and Monte Serreno do not currently have a TOT.

According to the Town's Operating and Capital Summary Budget for Fiscal Year 2023/24, the following table shows the forecasted TOT collections for Fiscal Years 2025/26 through 2028/29, including what each 1% yields:

FY	Forecasted TOT Collections	Each 1% Yields ¹
2025/26	\$ 2,600,000	\$ 216,667
2026/27	2,600,000	216,667
2027/28	2,600,000	216,667
2028/29	2,700,000	225,000

1 - Current TOT rate is 12%

The following table shows the potential revenue generated via various increases in the Town's TOT rate for Fiscal Years 2025/26 through 2028/29:

Potential TOT Increase	Potential New Total TOT %	Additional Revenue 2025/26 Projected	Additional Revenue 2026/27 Projected	Additional Revenue 2027/28 Projected	Additional Revenue 2028/29 Projected
0.25%	12.25%	\$ 54,167	\$ 54,167	\$ 54,167	\$ 56,250
0.50%	12.50%	108,333	108,333	108,333	112,500
0.75%	12.75%	162,500	162,500	162,500	168,750
1.00%	13.00%	216,667	216,667	216,667	225,000
1.25%	13.25%	270,833	270,833	270,833	281,250
1.50%	13.50%	325,000	325,000	325,000	337,500
1.75%	13.75%	379,167	379,167	379,167	393,750
2.00%	14.00%	433,333	433,333	433,333	450,000
2.25%	14.25%	487,500	487,500	487,500	506,250
2.50%	14.50%	541,667	541,667	541,667	562,500
2.75%	14.75%	595,833	595,833	595,833	618,750
3.00%	15.00%	650,000	650,000	650,000	675,000
3.25%	15.25%	704,167	704,167	704,167	731,250
3.50%	15.50%	758,333	758,333	758,333	787,500

The following table shows how the maximum estimated additional TOT revenue (3.50% increase) in the table above would affect the Town's forecasted deficits:

Item	FY 2025/26	FY 2026/27	FY 2027/28	FY 2028/29
Forecasted Surplus/(Deficit), in Millions	(\$2.8)	(\$3.1)	(\$3.3)	(\$3.8)
TOT Revenue @ 15.50%, in Millions	0.8	0.8	0.8	0.8
Forecasted Surplus/(Deficit), in Millions	(\$2.0)	(\$2.3)	(\$2.5)	(\$3.0)

NBS does not recommend increasing the TOT rate, as any potential increase doesn't raise that much additional revenue to support the Town's budget deficit.

Business License Tax Modification

The Town may also have an interest in exploring a modification to its Business License Tax to add a charge per employee. NBS is not modeling what the rate per employee would be as the Town does not yet know the number of employees that would be subject to the tax. It's also worth noting here that voters in the Town approved an increase to the Business License Tax in November 2022 (Measure J), so perhaps it's too soon to ask the voters for another modification.

Recommended Revenue Options

Sales Tax Rate Modeling

The current sales tax rate in the Town is 9.25%, of which the Town's share is 1% (not including the Measure G sales tax rate of 0.125%). The Town has the capacity to raise its sales tax rate by an additional 0.125%.

According to the Town's Operating and Capital Summary Budget for Fiscal Year 2023/24, the following table shows the forecasted sales tax collections for Fiscal Years 2025/26 through 2028/29, including what each 1% yields:

FY	Forecasted Sales Tax Collections	Each 1% Yields ¹
2025/26	\$ 8,500,000	\$ 8,500,000
2026/27	8,700,000	8,700,000
2027/28	9,000,000	9,000,000
2028/29	9,300,000	9,300,000

1 - Current sales tax rate is 9.25%, of which the City receives 1% (does not include Measure G sales tax rate of 0.125%)

The following table shows the potential revenue generated via a 0.125% increase in the Town's sales tax rate for Fiscal Years 2025/26 through 2028/29:

Potential Sales Tax Increase	Potential New Total Sales Tax %	Additional Revenue 2025/26 Projected	Additional Revenue 2026/27 Projected	Additional Revenue 2027/28 Projected	Additional Revenue 2028/29 Projected
0.125%	9.375%	\$ 1,062,500	\$ 1,087,500	\$ 1,125,000	\$ 1,162,500

The following table shows how the estimated additional sales tax revenue would affect the Town's forecasted deficits:

Item	FY 2025/26	FY 2026/27	FY 2027/28	FY 2028/29
Forecasted Surplus/(Deficit), in Millions	(\$2.8)	(\$3.1)	(\$3.3)	(\$3.8)
Sales Tax Revenue, in Millions	1.1	1.1	1.1	1.2
Forecasted Surplus/(Deficit), in Millions	(\$1.7)	(\$2.0)	(\$2.2)	(\$2.6)

It's worth noting here that Campbell, Milpitas, and San Jose already have a 9.375% sales tax rate, while all other cities (excluding the Town) in Santa Clara County and the unincorporated areas of Santa Clara County are currently subject to a sales tax rate of 9.125%.

The amount of revenue generated by a potential sales tax increase does not completely fill the Town's budget deficit, but it is higher than the potential revenue generated by an increase in the Town's TOT rate and could potentially serve as a "first step" for the Town to raise additional revenue. If structured as a general sales tax, the Town would only need to secure approval from a majority of the registered voters within the Town to increase the sales tax rate. NBS recommends that the Town move quickly on this option, if desired, as the Town's remaining capacity for a sales tax increase could be utilized by another government agency within the County during the next election cycle.

Parcel Tax Scenarios

For purposes of modeling a new parcel tax, the Town has provided four revenue target scenarios to fill its projected operating deficits: a consensus target of \$3.5MM, a high target of \$4MM, a middle target of \$2MM, and a low target of \$1MM, as shown below:

Revenue Target	Amount
High	\$ 4,000,000
Consensus	\$ 3,500,000
Middle	\$ 2,000,000
Low	\$ 1,000,000

Our analysis assumes that the parcel tax, if approved in November 2024, would be collected beginning in Fiscal Year 2025/26, and rates would increase by 3% per year. The following table shows how each of the four revenue target scenarios for a potential parcel tax would affect the Town's forecasted deficits:

Item	FY 2025/26	FY 2026/27	FY 2027/28	FY 2028/29
Forecasted Surplus/(Deficit), in Millions	(\$2.8)	(\$3.1)	(\$3.3)	(\$3.8)
Parcel Tax Revenue, in Millions (High)	4.0	4.1	4.2	4.4
Forecasted Surplus/(Deficit), in Millions (High)	\$1.2	\$1.0	\$0.9	\$0.6
Parcel Tax Revenue, in Millions (Consensus)	3.5	3.6	3.7	3.8
Forecasted Surplus/(Deficit), in Millions (Consensus)	\$0.7	\$0.5	\$0.4	\$0.0
Parcel Tax Revenue, in Millions (Middle)	2.0	2.1	2.1	2.2
Forecasted Surplus/(Deficit), in Millions (Middle)	(\$0.8)	(\$1.0)	(\$1.2)	(\$1.6)
Parcel Tax Revenue, in Millions (Low)	1.0	1.0	1.1	1.1
Forecasted Surplus/(Deficit), in Millions (Low)	(\$1.8)	(\$2.1)	(\$2.2)	(\$2.7)

Based on the latest Santa Clara County Assessor's data from July 2023, there are a total of 11,230 parcels within the Town that would be Taxable, and an additional 365 parcels that would be Non-Taxable (generally publicly owned parcels, utilities, common areas, mobile homes, or other parcels with no assessed value). We provide below three parcel tax scenarios for each of the four revenue targets scenarios: (1) a uniform rate per parcel, (2) a uniform rate per lot square foot, (3) a uniform rate per building square foot, (4) a uniform rate per parcel with senior/low-income exemptions, (5) a uniform rate per lot square foot with senior/low-income exemptions, and (6) a uniform rate per building square foot with senior/low-income exemptions.

Without Senior/Low-Income Exemptions

Description	Rate - High	Rate - Consensus	Rate - Mid	Rate - Low
Taxable Parcels - per Parcel	\$ 356.19	\$ 311.67	\$ 178.09	\$ 89.05
Taxable Parcels - per Lot Square Foot	\$ 0.0203	\$ 0.0178	\$ 0.0102	\$ 0.0051
Taxable Parcels - per Building Square Foot	\$ 0.14	\$ 0.12	\$ 0.07	\$ 0.03

The average taxes on SFR and Condo parcels under the consensus revenue target for the three different apportionment methods are shown below:

Average of Parcel Tax - By Parcel	Average of Parcel Tax - By LotSqFt	Average of Parcel Tax - By BldgSqFt
\$ 311.67	\$ 254.10	\$ 262.08

With Senior/Low-Income Exemptions

For the purposes of this analysis, we have assumed that 10% of Taxable single-family residential parcels, 10% of Taxable single-family residential lot area, or 10% of Taxable single-family residential building area could qualify for a senior/low-income exemption, if offered.

Description	Rate - High	Rate - Consensus	Rate - Mid	Rate - Low
Taxable Parcels - per Parcel	\$ 390.82	\$ 341.96	\$ 195.41	\$ 97.70
Taxable Parcels - per Lot Square Foot	\$ 0.0219	\$ 0.0192	\$ 0.0110	\$ 0.0055
Taxable Parcels - per Building Square Foot	\$ 0.15	\$ 0.13	\$ 0.07	\$ 0.04

The average taxes on SFR and Condo parcels under the consensus revenue target for the three different apportionment methods are shown below:

Average of Parcel Tax - By Parcel (SLI)	Average of Parcel Tax - By LotSqFt (SLI)	Average of Parcel Tax - By BldgSqFt (SLI)
\$ 341.96	\$ 273.89	\$ 283.18

Commercial/Office/Industrial Parcels Only

The Town has also requested a scenario for a parcel tax that would only apply to Taxable Commercial/Office/Industrial Properties at a rate per building square foot over 25k building square feet. The rates per building square foot over 25k building square feet for each of the revenue targets are shown below:

Description	Rate - High	Rate - Consensus	Rate - Mid	Rate - Low
Taxable Commercial/Office/Industrial Parcels - per Building Square Foot > 25K	\$ 3.31	\$ 2.90	\$ 1.66	\$ 0.83

There are 35 Commercial/Office/Industrial parcels with buildings of 25,000 square feet or more and the resulting annual tax per owner would range from approximately \$4,600 to \$612,000.

The parcel tax option is the only reliable way to correct the Town's projected deficits with one funding mechanism, however attaining two-thirds approval from voters at the rates that meet that objective may be difficult. I look forward to our upcoming meeting to discuss these revenue scenarios and the resulting model results. Please contact me with any questions or comments; I can be reached at 800. 676.7516 or via email at ndayhoff@nbsgov.com.

Sincerely,

A handwritten signature in blue ink, appearing to read "Nick Dayhoff", with a long, sweeping horizontal line extending to the right.

Nick Dayhoff
Senior Consultant