THE CITY OF SAN DIEGO

MANAGER'S REPORT

DATE ISSUED: March 28, 2003 REPORT NO. 03-061 (REVISED)

ATTENTION: The Committee on Rules, Finance and Intergovernmental Relations Agenda of April 2, 2003

SUBJECT: Opportunities for the expansion of current revenue

REFERENCE: Blue Ribbon Committee Report on City of San Diego Finances – February 2002
Blue Ribbon Options/Rules Committee Actions – Memo April 2002
Facilities Financing Study, prepared for the Strategic Framework Citizen Committee Finance Subcommittee – July, 2002

SUMMARY

Issue - Should the City Council direct the City Manager to pursue the expansion of current revenue as recommended by the Blue Ribbon Committee on City of San Diego Finances?

Manager's Recommendation – Direct the City Manager to pursue the expansion of current revenue as recommended by the Blue Ribbon Committee on City of San Diego Finances.

Other Recommendations – None.

Fiscal Impact – The fiscal impact is dependent upon which of the new revenue sources, if any, are pursued.

BACKGROUND

On April 15, 2002 the City Council adopted the Blue Ribbon Committee Report, which evaluated the City's current fiscal health and made several recommendations. The seventh recommendation of the Committee is:

> *Recommendation #7: Expand the current revenue sources and seek additional sources of revenue (See Attachment A).*

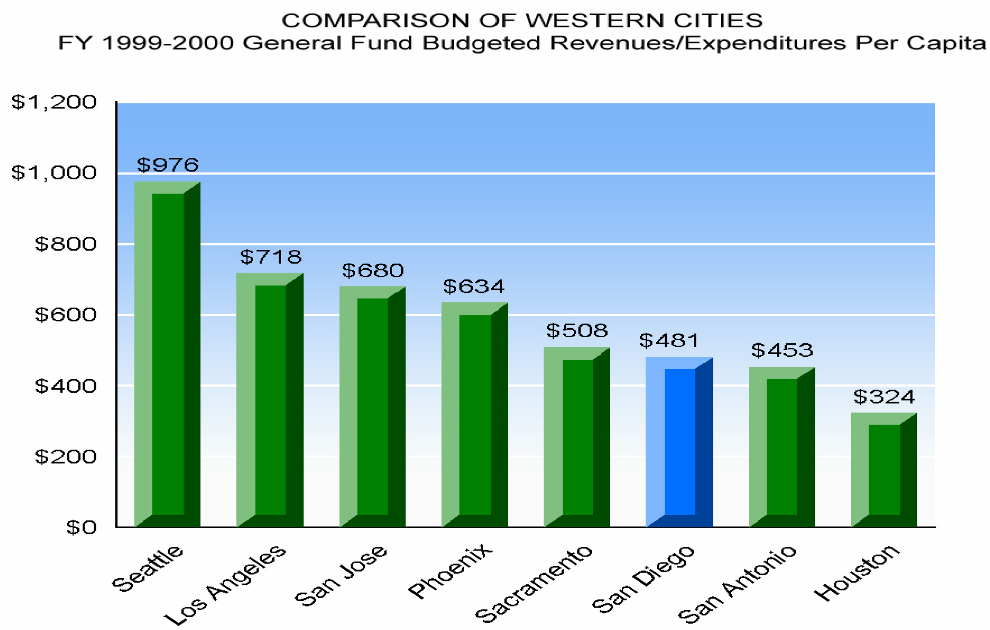
In a memo dated April 4, 2002, the Mayor directed the City Manager to prepare a response to the Committee on Rules, Finance and Intergovernmental Relations regarding the expansion of current revenue sources and identification of additional revenue sources.

CURRENT FISCAL CONDITION

The City's current financial situation, coupled with the lingering effects of the recent economic downturn and the City's low per capita revenue compared to the rest of California cities as noted in the Blue Ribbon Committee Report, underscores the importance of identifying new revenue sources or expanding the existing ones. Economic uncertainty resulting from sluggish job growth, declining consumer confidence and the war in Iraq further enhances the long-term financial challenge facing the City of San Diego to keep service levels from further decline. Expenditures such as new facility operating costs, utilities and insurance, worker's compensation, inflationary increases, and negotiated salary and retirement increases, are even more challenging to maintain given the difficult economic times. It is projected that growth and inflationary costs will increase by over $42 million in Fiscal Year 2004, while major General Fund revenues are expected to increase only $8 - 10 million. In a City recognized as efficient, this means that other City services will be reduced in order to achieve a balanced budget. This is before any potential cuts are made by the State of California.

Relative to peer cities, San Diego has historically had a comparatively low tax-related revenue base. San Diego does not charge for residential refuse collection and has never implemented a Utility User Tax as many California cities have done. Furthermore, San Diego has a relatively low Transient Occupancy Tax and Business License Fees. The graph on page 3 demonstrates San Diego's low tax base by comparing per-capita tax revenue of several major West Coast cities.

The City of San Diego's philosophy has been to live within its means. The City has taken efforts to reduce expenditures and provide services effectively and efficiently through Performance Based Budgeting and the Organization Effectiveness and Optimization programs. As highlighted in the Fiscal Year 2004 Financial Forecast report, most General Fund departments were required to make a two percent expenditure reduction in Fiscal Year 2002, a two percent budget reduction at the beginning of Fiscal Year 2003, a three percent expenditure reduction during Fiscal Year



2003, and nearly $30 million in budget reductions in preparation for Fiscal Year 2004. The City is limited in the ability to provide customer services at the expected levels of the community for priority areas such as public safety, parks and recreation, libraries, streets and deferred maintenance due to funding constraints.

In addition, there are several needs that require additional funding:

- Basic Operating Needs – to provide customer service at expected levels of the community
- Deferred Maintenance
- Fleet/Fire Apparatus
- The Strategic Framework – the infrastructure needed to support the "City of Villages" concept
- New Facilities – facilities are being developed that need funding to operate
- National Pollution Discharge Elimination System (NPDES) Permit – to fund efforts

to meet permit requirements
- Growing Population

Throughout the past decade, efforts have been made to incorporate new General Fund revenue options into the City's Budget. However, the City of San Diego has assessed few new fees or adopted increases to existing revenue sources. The only significant new fees or revenue increases were the implementation of the Refuse Collector Business License Tax, an increase in the Refuse Haulers Franchise Fee, and an increase in the Transient Occupancy Tax Rate from 9 percent to 10.5 percent, all adopted during the 1990's. In addition, the City has lowered business license fees in 1995 and again in 1996 in an effort to retain and encourage business growth.

State actions threaten to further reduce City revenues by over $60 million. As indicated in the Financial Forecast report presented to the City Council on March 17th, the Fiscal Year 2004 Proposed Budget does not currently take into account this potential revenue shortfall. If the State does withhold this revenue, the City will be forced to make substantial reductions to core services such as public safety, and further reductions to parks and recreation and libraries. In light of this situation, and the City's past philosophy of expenditure reductions, it is necessary to consider an increase in revenues to restore core services.

LEGISLATIVE CONSTRAINTS

Over the past several decades, various legislative actions have constricted the ability of municipalities to raise and collect revenue. Many of these developments take place on a statewide basis, but some pertain only to the City of San Diego. These major developments are outlined below.

In 1978, State voters approved Proposition 13, a constitutional amendment that limited ad valorem property taxes to 1 percent of the full cash value. This placed a limit on the amount of revenue that cities, counties and special districts could raise through property taxes. Proposition 13 was implemented in a manner that penalized efficient cities like San Diego by distributing property tax based on tax rates prior to Proposition 13.

Proposition 13 also introduced the notion of "special taxes," and the requirement that they be passed with a two-thirds vote. In 1982, the California Supreme Court ruled that special taxes are taxes that were earmarked for special purposes, in contrast to unrestricted general fund taxes.

In 1986, State voters approved Proposition 62, a statutory initiative that required majority voter approval of local general taxes and restated the two-thirds voter approval requirement for local special taxes. However, subsequent California court decisions labeled the majority vote requirement for general taxes unconstitutional. In response, many city and county governments increased or imposed new general taxes in the 1990's without voter approval. San Diego did not add these new types of fees and taxes, and in fact substantially reduced its business license taxes. These taxes commonly took the form of utility users taxes, business license fees and transient occupancy taxes. But in September 1995, the California State Supreme Court rendered

Proposition 62 constitutional by affirming the judgment of the District Court of Appeal in *Santa Clara County Local Transportation Authority v. Guardino.* The Court of Appeal deemed Santa Clara County's one-half cent transportation sales tax in violation of State Constitution because it was a special tax, yet only approved by a simple majority. The Supreme Court upheld the judgment on the grounds that the tax violated Proposition 62.

Constrained by Proposition 13 and confronted with shrinking budgets, many local governments looked for ways to raise revenues while avoiding Proposition 13's restrictions. They turned to property-related assessments, which traditionally were used to fund capital improvements that directly benefited property. Because Proposition 13 did not subject assessments to voter approval, local governments quickly broadened their use of assessments. In response, Proposition 218 was placed on the ballot in November 1996.

As a constitutional amendment, Proposition 218 strengthened and reiterated several components of previous tax laws. The following are some general highlights of Proposition 218's impact:

- Requires majority voter approval for all local general taxes and two-thirds voter approval for all local special taxes.
- Requires voter approval of increases to existing local taxes enacted after January 1, 1995.
- Applies to all local governments and special districts, including charter cities.
- Defines a special tax as any tax imposed for specific purposes, even if placed into a general fund.
- Requires majority property owner approval, after notice and public hearing, of benefit assessments, by weighted voting.
- Limits assessments to the special benefits conferred.
- Requires that all property-related service charges be levied only in an amount necessary to cover the costs of providing the service.
- Requires that the revenue derived from property-related charges must be used solely for the purpose of financing the service, and for no other purpose.
- With the exception of fees for sewer, water and refuse collection services, property-related charges require either majority approval of affected property owners, or two-thirds approval of all voters prior to implementation.
- Provides that the initiative power shall not be restricted from reducing or repealing local taxes, assessments and fees.
- Caused bond rating agencies to downgrade most California cities' credit ratings due to diminished financial flexibility.

For the City of San Diego, the ability to generate new revenue recently became more difficult. In the March 2002 California Primary Election, San Diego voters approved Proposition E – the Taxpayers Protection Act – with a majority vote. Proposition E requires a two-thirds majority vote to levy new general taxes or increase existing general taxes. The City of San Diego responded with Proposition F, a counter-measure requiring that any Charter amendment, ballot proposal, initiative, statute, law or regulation that imposes a vote requirement of more than a simple majority must itself be adopted by the same proportionate vote of the electorate. In other words, Proposition E would have to pass by a two-thirds majority to become effective. Both propositions passed, but neither garnered a two-thirds vote. To date, Proposition E has not been filed with the Secretary of State. It is the opinion of the City that Proposition E did not pass, and thus remains ineffective. The proponents of Proposition E disagree. The dispute is the subject of pending litigation in the San Diego Superior Court, which is scheduled to issue a ruling April 2003 on the validity of Proposition E. Regardless of the outcome, the case is likely to be appealed to the Fourth District Court of Appeals.

Finally, it should be emphasized that most options in this report, if pursued, will likely have limited or no impact on the City's finances in Fiscal Year 2003 and less than a full year in Fiscal Year 2004. There are no scheduled elections in calendar year 2003, so any regular vote that is to be held on new or increased taxes will likely have to wait until 2004. Although it is possible to hold a special election before 2004, such an election would be held at an estimated cost of $1.2 million, thus partially offsetting any potential revenue generated from new taxes. Two other possibilities exist that could expedite the implementation of new revenue sources. First, if the Governor holds a special State election, it might be possible for the City of San Diego to hold a special election at a reduced cost. However, sources indicate that it is unlikely that a Governor's special election will be held. Second, the City may want to consider a special mail ballot election. Such an election was held in 1981 at an estimated 40 percent costs savings over a conventional election. With a special election or mail ballot, any new taxes or fees requiring voter approval could become effective in Fiscal Year 2004.

DISCUSSION

After reviewing the revenue sources utilized by a number of California cities, several current or new sources of revenue have been identified as having potential to positively impact General Fund revenue for the City of San Diego. These sources were analyzed by examining the type of funding, how San Diego compares with other California cities, and potential impacts. The following sources of revenue are discussed:

- Business License Tax
- Franchise Fees
- Parking Tax
- Property Transfer Tax
- Refuse Collection Fee
- Sales Tax
- Storm Drain Fee
- Transient Occupancy Tax
- Utility Users Tax
- Other Revenue Sources

In addition to the major revenue sources analyzed in this report, several other sources of new revenue have been identified as well. The other revenue sources include an Admission Tax, Paramedic Subscription Fee, Public Safety Property Tax Assessment, Retirement Tax, Special Event Support, Valet Parking Tax, and a 6 to 6 Registration Fee. These new sources of revenue are still being investigated and analyzed by City staff.

The recent Facilities Financing Study prepared for the Strategic Framework Citizen Committee is utilized in this report. That study selected a group of peer cities to be used as a basis of comparison with San Diego. Selection of these cities was based on similarities with regard to revenue-generating and financing activities. The cities include the City and County of San Francisco, the other top nine cities ranked by population, Irvine, and the cities of Santa Barbara and Santa Clara. The following is a list of San Diego's selected peer group cities:

- Anaheim
- Bakersfield
- Fresno
- Irvine
- Los Angeles
- Long Beach
- Oakland
- Sacramento
- San Francisco
- San Jose
- Santa Ana
- Santa Barbara
- Santa Clara

In addition, a few cities outside of California are used as a basis of comparison for certain revenue sources, due to the lack of comparability with California cities.

VOTER REQUIREMENT

According to Proposition 218, all general taxes require a majority vote of the electorate and all special taxes require a two-thirds vote. Most revenue sources discussed in this report, including Business License Tax, Parking Tax, Property Transfer Tax, Sales Tax, Transient Occupancy Tax, and Utility User Fees, fall into this category. Refuse Collection Fees are exempt from the voter requirements of Proposition 218, but require a majority vote to amend San Diego Municipal Code. Franchise Fees are not covered by Proposition 218, and are negotiated with individual utility companies.

VOTER REQUIREMENT

Revenue Source	Proposition 218 Restriction	Voter Requirement	Potential Revenue
Business License Tax	Yes	Majority*	5.3 million
Franchise Fees	No	None	$800,000**
Parking Lot Tax	Yes	Majority*	$19.6 million
Property Transfer Tax	Yes	Majority*	$6 million
Refuse Collection Fees	No	Majority, to amend municipal code	$39 - 45 million***
Sales Tax	Yes	Majority*	$97 million
Storm Drain Fee	Yes	Majority of property owners	*Under investigation*
Transient Occupancy Tax	Yes	Majority*	$15.5 million
Utility User Fee	Yes	Majority*	$18.5 million
Other Revenue Sources	*Voter requirements currently undergoing further evaluation*		

* This assumes revenue will be used for general purposes. If revenue is earmarked for specific purposes, then a two-thirds vote will be required.
** Based on the proposed $1/ton increase in the Refuse Hauler Franchise Fee.
*** Based on a $10 - $13 monthly charge per household that receives municipal refuse collection service.

Several sources of revenue are currently being evaluated by the City Attorney and City staff to determine the voter requirement. These sources include Admission Tax, Paramedic Subscription Fee, Public Safety Property Tax Assessment, Rental Car Tax, Retirement Tax, Special Event Support, Storm Drain Fees, and the 6 to 6 Registration Fee. The voter requirements for the revenue sources discussed in this report are summarized in the table above.

In considering new revenue sources, consideration should be given to implementing revenue sources that are broadbased and equitable. Different sources of revenue impact different groups. For instance, the Transient Occupancy Tax is paid mainly by tourists and non-residents, while a Residential Refuse Collection Fee will fall primarily on San Diego residents. Business License Taxes will affect San Diego businesses directly in the form of higher taxes, and local consumers indirectly in the form of higher prices. Sales Tax, on the other hand, will affect all entities that make purchases in San Diego, whether residents, businesses, or tourists. Community input and cooperation with industry groups such as the San Diego Chamber of Commerce, the Taxpayers Association, Hotel-Motel Association, San Diego Convention and Visitors Bureau, League of Women Voters, and Economic Development Corporation is essential in developing major revenue options that are fair and balanced on a City and industry-wide basis.

BUSINESS LICENSE TAX

Business license taxes are charged to businesses for the privilege of conducting operations within a city's boundaries. These taxes are levied in many different ways, most commonly as a percentage of gross receipts or a fixed charge per employee. Often, rates are tiered depending on the size of the business or number of employees. Different rates are often charged to different types of businesses.

How San Diego Compares

Currently the City of San Diego levies a business license tax that is based on the number of employees. For businesses with less than 12 employees, the City charges a flat rate of $34. This fee was lowered in 1996 from a flat $70 fee and $3 per employee. For businesses with 13 or more employees, the City charges a flat rate of $125 plus $5 per employee. In Fiscal Year 2002, the City received $5.3 million in business license taxes, accounting for just 0.7 percent of all General Fund revenue.

Compared to its peer cities, San Diego's business license taxes are relatively low. In Fiscal Year 2000 only two of the peer cities that impose a business license tax collected less revenue than San Diego. Furthermore, San Diego had the lowest revenue per capita ($3.83) and the lowest revenue as a percentage of the General Fund (0.7 percent). Bakersfield had the next lowest revenue per capita with $7.64 and Sacramento had the next lowest revenue as a percentage of General Fund, at 2.2 percent. The City of Los Angeles, which levies the tax as a percentage of gross receipts, collected $319.2 million from business license taxes in Fiscal Year 2000, accounting for 11.1 percent of the General Fund. San Francisco charged 1.5 percent of payroll the same year, collecting $267.2 million, or $336.65 per person, comprising 14.4 percent of General Fund revenue.

Potential Impacts

Business license taxes are an important determinant of business location and expansion. Increasing business license taxes beyond the competitive level may deter new businesses from locating in San Diego and existing businesses from expanding within city limits. San Diego has very attractive business tax rates, and factors such as lease rates, retail and office space vacancy, local wages, and land prices should also be taken into account.

Options

San Diego currently has very low business license tax rates; the City stands to gain a modest amount of revenue if rates are increased. Based on Fiscal Year 2002 actual figures, even doubling the current rates would generate an additional $5.3 million in revenue. San Diego's rates are currently far below those of other major California cities, and an increase in such a low rate is unlikely to have a large negative impact on attracting and retaining local businesses.

FRANCHISE FEES

Franchise fees are fees paid to the city by private utility companies for the privilege of using the city's rights-of-way. State statute limits payments from gas and electric franchises to general law cities (cities that are governed by state laws) to 2 percent of the franchisee's gross annual receipts. Charter cities (cities that are governed by local charter and that are subject only to constitutional limitations) may set fees in excess of the 2 percent limit.

As a charter city, San Diego may charge a franchise fee higher than 2 percent. Currently, San Diego charges different "Franchise Rents" to different utilities. The largest source of revenue comes from SDG&E, which is charged 3 percent of gross sales. Twenty-five percent of the franchise revenue collected from SDG&E is deposited into the Environmental Growth Fund; the remaining amount is reserved for the General Fund. The City collects franchise rents from Cox Cable and Time Warner, charging 5 percent and 3 percent, respectively. San Diego also charges private refuse collectors a franchise fee based on tons of refuse collected and hauled. In Fiscal Year 2003 San Diego is budgeted to receive a total of $66.1 million in franchise revenue, $54.3 million of which will go to the General Fund. This source provides for 7.4 percent of General Fund revenues.

After renegotiating a franchise agreement with SDG&E in January 2002, the City Council approved an ordinance that renewed the existing 3 percent franchise fee, and provided for a 4.5 percent surcharge for the undergrounding of electric utility lines. The surcharge is estimated to raise $36 million per year for the City, which will be used solely for placing utility lines underground. Because this agreement would result in higher fees charged to consumers, its implementation was contingent upon approval by the California Public Utilities Commission. In May 2002, SDG&E filed an Advise Letter with the PUC requesting approval of the fee increase. The Commission approved the fee increase in Resolution E-3788 on December 19, 2002.

How San Diego Compares

In terms of franchise fee revenue, San Diego is near the top of the list in several respects. First, among peer cities, only Los Angeles collects more franchise revenue, receiving $49.3 million in Fiscal Year 2000. The same year San Diego received $38.6 million in franchise revenue, and the City of San Jose collected $30.3 million. The next highest receipt of franchise revenue was by San Francisco, with just $9.4 million. Secondly, San Diego trails only San Jose in franchise revenue as a percentage of General Fund, at 5.8 percent and 5.9 percent respectively. In contrast, franchise revenue for Los Angeles accounted for just 1.2 percent of the General Fund. Comparisons of this type are difficult, however, because of the different ways utilities are provided. For example, franchise fees for the City of Los Angeles comprise just 1.2 percent of the General Fund because the City's electric utility is a city enterprise, and generates General Fund revenue via transfers, not franchise fees.

Potential Impacts

The Potential Impacts related to franchise fees are the same as with the utility users tax. Demand for utility services is typically inelastic, meaning that the demand for services will not change much as price changes. Thus any fee or charge imposed on a utility will be passed on to consumers. Local businesses would also face higher utility bills, raising costs and discouraging local expansion and investment. Higher utility costs would also degrade San Diego's competitive edge in attracting new businesses.

Options

Because Franchise Fees are usually set through negotiation with individual utility companies, the only option to increase revenue from this source is to renegotiate the franchise agreements when the current contracts expire or become available for renegotiation. The Refuse Hauler Franchise Fee is a notable exception. Under Municipal Code Section 66.0118, the rates charged to private refuse collectors may be changed at any time by a resolution of the City Council. The Refuse Hauler Franchise Fee was increased by $1 per ton last year, and another increase will be proposed by the Environmental Services Department in April 2003. The proposed $1 increase will generate approximately $850,000 per year for the General Fund. The franchise agreement between the City of San Diego and SDG&E was renegotiated in January 2002 and expires in 2020. A new franchise agreement with Cox Cable became effective on July 1, 2002, increasing the franchise fee from three percent to five percent. The contract will expire in January 2019. The City's franchise agreement with Time Warner became effective in April of 1980, and is set to expire in April of 2010.

PARKING TAX

A Parking Tax is levied on the gross receipts from all financial transactions involving the parking or storing of automobiles or other motor vehicles in outdoor or indoor parking lots and garages. Parking facility operators are responsible for issuing the claim check, collecting the tax and remitting the revenue to the city.

How San Diego Compares

Currently, the City of San Diego does not levy a parking tax. The cities of Los Angeles and Santa Monica both charge a 10 percent tax on each parking transaction. In Fiscal Year 2003 this tax was budgeted to raise nearly $58.7 million in General Fund revenue for Los Angeles. San Francisco is budgeted to receive $57.3 million in Fiscal Year 2003 from their 25 percent parking tax.

Potential Impacts

Imposing a parking tax would increase the rate that motorists will have to pay for parking. Coupled with the increase in fuel prices, this could motivate more commuters to take public transportation, reducing traffic and congestion on the City's freeways, streets and parking facilities.

Options

Many cities currently employ a parking tax, achieving significant General Fund revenue. If the City of San Diego employed a comparable 10 percent parking tax, approximately $19.6 million in additional General Fund revenue could be attained.

PROPERTY TRANSFER TAX

The property transfer tax is a tax paid on the sale of any real property. It is also referred to as a documentary transfer tax or a real estate transfer tax. Most cities levy a so-called "conforming" tax, whereby the county collects $1.10 per $1,000 of sales price. Of this amount, $0.55 is allocated to the city in which the property was sold. As a result, both the city and the county receive $0.55 per $1,000 of the sale price.

Property transfer taxes may also be "non-conforming." Some cities levy a non-conforming property transfer tax at a rate above $0.55 per $1,000. In these cases, the county receives the full share of the $1.10 per $1,000, and the city receives the amount generated from its own tax rate.

The tax is based on the purchase price of the property at time of sale. Most conforming taxes are paid by the seller; non-conforming taxes are often split between the seller and buyer in accordance with local practice and individual real estate contracts.

How San Diego Compares

The City of San Diego currently employs a conforming property transfer tax, collecting $0.55

per $1,000 of sale price. In Fiscal Year 2003 the City is budgeted to receive $6.3 million in property transfer tax revenue, accounting for just 0.86 percent of General Fund revenues.

Five of San Diego's peer cities utilize a non-conforming property transfer tax. The City of Oakland has the highest tax at $15 per $1,000 and Sacramento the lowest at $2.75 per $1,000. San Francisco employs a three-tiered tax rate system, charging a different rate depending upon the value of the property. In Fiscal Year 2000 Oakland collected $34.4 million in property transfer tax revenue, 9.3 percent of its General Fund. Los Angeles, charging $4.50 per $1,000, collected $87 in Fiscal Year 2000, or 2.1 percent of its General Fund. Sacramento's receipts of nearly $5 million contributed 2 percent to General Fund revenues.

Potential Impacts

Increasing property transfer taxes may have an impact on San Diego's housing market, which may in turn affect property tax revenue. A tax on property transfer reduces the incentive to sell or purchase property. However, the transfer tax is a small percentage of the value of the property (currently just 0.11%), and it is unlikely an incremental increase in the tax rate would have any effect on the housing market.

Options

Under Proposition 218, an increase in the property transfer tax would be subject to simple majority voter approval. Doubling the property transfer tax rate would result in an increase of over $6 million to the City's General Fund revenues. However, it must be noted that the tax burden to property buyers and sellers would increase by the *full amount* of the new City tax rate, not just by the amount of the rate *increase*. The county would continue to charge $1.10 per $1,000 (the total amount collected now) and the City would charge its own, non-conforming rate. If the City wished to collect $1.10 per $1,000 of sale price, the total tax burden facing property buyers and sellers would be $2.20 per $1,000 of sale price ($1.10 to the County and $1.10 to the City). But again, even this rate is only 0.22% of the total property value. Such a small tax increase is unlikely to have any effect on the housing market.

REFUSE COLLECTION FEES

Refuse collection fees are charged for the service of residential refuse collection. Fees are most commonly levied as a flat monthly charge for each refuse container used by a residence. In many cities, residential refuse is collected by a private hauling company. In these cases, the private companies will charge residents for the services, and the city will collect revenue through franchise fees. Charges often vary depending on the capacity of the trash receptacle used, as well as for other services such as recycling or green waste collection.

The People's Ordinance (Municipal Code Section 66.0127), enacted by voters in 1919 prohibits the City from charging a fee for municipal refuse collection. The Ordinance was originally enacted for two primary reasons. First, residents did not like being charged for garbage collection by private contractors. These contractors would then turn around and use the waste as hog feed, and eventually sell the hogs for a profit. Secondly, many residents were illegally dumping or burning their waste to avoid the charge for trash collection. By 1913, this practice had become so prevalent that the Board of Health wrote to the City Council and advocated municipal refuse collection.

How San Diego Compares

The City of San Diego does not currently charge a refuse collection fee for municipal refuse collection services. It is the only city among the peer group that does not attempt to recoup at least a portion of the cost of residential refuse collection and disposal. The City of Fresno levies a charge of $16.44 per month for a 96-gallon container, and $12.44 per month for a 64-gallon container. In Fiscal Year 2000, these charges provided the city with $30.3 million. Sacramento charges $14.35 per month for a 90-gallon container, $12.60 for a 60-gallon container, and $11.27 for a 30-gallon container. In Fiscal Year 2000 the city collected $20.1 million in refuse collection fees.

Potential Impacts

Implementing a refuse collection fee will help to reduce the overall amount of garbage that is generated by giving households an incentive to create less waste. As the “cost” of generating waste increases, people will become less wasteful and look for alternatives to dispose of waste, such as recycling. This will ease the burden on the city’s landfills and work toward accomplishing the goal outlined by Assembly Bill 939 of 50% waste reduction. A refuse collection fee will be particularly effective in this manner if charges differ depending on the amount of refuse that is generated. One possible way of implementing this is to levy a different charge for different size trash receptacles.

A concern is that residents may respond to a refuse collection fee by illegally dumping their waste in order to avoid the charge. Ironically, this was one of the key reasons the City decided to go to mandatory municipal collection in the first place. However, the Environmental Services Department believes that illegal dumping would not be a major issue, and that current City forces are adequate to handle any new dumping that might occur.

Options

Currently, many San Diego residents are charged for refuse collection by private haulers because they do not receive municipal refuse collection services. Since these residents are not given an equivalent tax break, they bear a disproportionate share of the tax burden relative to residents who receive free trash collection. Implementing a residential refuse collection fee for municipal refuse collection would restore parity among San Diego residents.

Refuse collection charges are specifically exempt from the voter-requirement of Proposition 218. However, a majority vote would be required to amend the City Municipal Code. The

Environmental Services Departments recommends that any revision of the People's Ordinance should preserve trash collection for single family residences by City forces, provide for mandatory collection for all single-family residential properties in the City to insure public health is protected, more accurately define which commercial and multi-family residential units need to have commercial service by the City's franchised haulers, and give the City Council the authority to establish collection fees that recover the cost of the service.

In Fiscal Year 2003, the total General Fund expenditure on residential refuse collection is approximately $35 million, which does not include overhead and administrative costs. The Environmental Services Department has estimated that a monthly refuse collection fee of $10 – $13 would generate approximately $39 – $45 million per year, covering the cost of residential refuse collection.

SALES TAX

Sales Tax is the largest source of non-property tax revenue for the City's General Fund. It is a tax levied on the retail price of tangible personal property sold in California. The State Legislature determines the tax rate, which currently stands at 7.25 percent of retail price. Of this percentage, the state collects 5.5 percent, cities collect 1.0 percent for general fund purposes and counties collect 0.25 percent. The remaining 0.5 percent is allocated to cities and counties (0.25 percent each) for the purpose of funding public safety. Counties may levy an additional local sales tax, up to an aggregate of 1.5 percent, for general or special purposes. Cities may levy additional sales taxes only with special State legislation and approval by local voters. The table below shows a detailed breakdown of the statewide sales tax rate.

Jurisdiction	**Rate**
State	5.50%
Local Public Safety	0.50%
Cities	1.00%
Counties	0.25%
Total Statewide Rate	7.25%

<u>How San Diego Compares</u>

San Diego County currently imposes a sales tax rate of 7.75 percent. This reflects the statewide rate of 7.25 percent, plus a half-cent supplemental tax, approved by voters in 1987. This half-cent supplemental sales tax was approved to finance TransNet, a 20-year, $3.3 billion transportation improvement program. TransNet funds have been allocated to expand and improve the region's highway system, local roads and streets, and bikeways and walkways. The table on page 10 gives a detailed breakdown of the rate charged within the City of San Diego.

In Fiscal Year 2003 the City of San Diego is budgeted to receive $201.3 million in total sales tax revenue, including revenue from the local public safety sales tax. Of this amount, the General Fund is budgeted to receive $136.4 million (again, including safety sales tax), comprising approximately 18 percent of total General Fund revenue. The half-cent supplemental sales tax is budgeted to provide the City with $25.8 million for TransNet projects.

Jurisdiction	**Rate**
State	5.50%
Local Public Safety	0.50%
San Diego City	1.00%
San Diego County	0.25%
TransNet (San Diego County)	0.50%
Total San Diego Rate	7.75%

Of the 13 peer cities surveyed, only Los Angeles collects more sales tax revenue. However, several cities collect more revenue when considered on a per capita basis. In Fiscal Year 2000 the City of San Diego collected $141 per person in sales tax revenue. In comparison, the City of Santa Clara, which collected just $43.4 million in total sales tax revenue, had per capita revenue of $415. Likewise, the cities of Santa Barbara, San Francisco, San Jose, Bakersfield, and Sacramento collected more sales tax revenue per capita than San Diego.

Two recent examples demonstrate the feasibility of voter-approved sales tax increases. First, in 1996 the County of Santa Clara (encompassing the peer cities of Santa Clara and San Jose) passed Measure B, a voter-approved half-cent general sales tax. Measure B was approved for nine years, expiring in 2006. In August 2000, county voters approved a 30-year half-cent cent sales tax for transportation improvements, set to take effect in 2006 when Measure B expires. Under Proposition 218, the county needed a two-thirds majority vote to levy the tax. The Measure passed with more than 70 percent of the votes.

In November 2000, the County of Alameda (encompassing the City of Oakland) passed Measure B, a 20-year half-cent sales tax for Public Transit improvements. The tax took effect April 1, 2002, when the existing half-cent sales tax expired after a 15-year duration. The Measure was originally voted on in 1998, but failed to garner the necessary two-thirds majority approval. By the 2000 election, the Measure was modified to place greater emphasis on Public Transit, alleviating concerns of several environmental groups. It passed easily with 81% of the vote.

Potential Impacts

Increasing sales taxes may have an important effect on land use and development planning. The California Planning Roundtable writes, "Many local governments have no incentive to approve much-needed housing projects – especially affordable housing projects – because they are money-losers for the local budget…while rejecting housing, cities and counties have engaged in destructive competition for retail development." Increasing the sales tax rate may exacerbate this problem by creating an incentive to further invest in retail development. However, it is also possible that an increase in the sales tax rate represents a responsible alternative to overdevelopment of retail, as increased revenues open the door for more affordable housing developments.

Another unintended consequence is that buyers may make purchases outside of San Diego County, where the sales tax may be lower. While it is unlikely that consumers will travel great distances to purchase standard items, big-ticket items and large contracts may be secured outside county lines.

Options

There are two main avenues by which San Diego can increase the sales tax rate. First, the County of San Diego may increase the sales tax rate on a countywide basis, subject to voter approval. The County of San Diego already charges a half-cent sales tax for TransNet, which is set to expire in 2008. The San Diego Regional Chamber of Commerce has supported a 30-year extension of the TransNet sales tax, but did not recommend that the rate be increased. The issue could be on the ballot as soon as 2004, complicating efforts to pass additional increases in the county's sales tax rate.

Secondly, the City of San Diego may increase the sales tax on a citywide basis with special state legislation and voter approval. A benefit of this method is that state legislation is permanent; local votes may occur repeatedly, regardless of prior outcome. However, any citywide sales tax rate would count against the county's 1.5 percent maximum, limiting the ability of the county to levy new sales tax increases.

Based on Fiscal Year 2003 budgeted amounts, a half-cent supplemental city-wide sales tax could increase City revenues by as much as $97.5 million. The City of San Diego could initiate state legislation granting the City authority to impose a half-cent supplemental sales tax. To allow for maximum flexibility legislation should be considered to allow for increases in quarter-cent increments, as well as grant the City the option of implementing the supplemental sales tax for general or specific purposes.

STORM DRAIN FEES

In response to increasing costs associated with the National Pollutant Discharge Elimination System (NPDES), many cities have begun to impose storm drain fees. These fees are typically levied as parcel charges, sometimes adjusted for the parcel area and amount of impervious surface area. Storm drain fees are also levied to fund routine maintenance and repair of a city's storm water system.

How San Diego Compares

Currently, the City of San Diego charges single family residences a flat fee of $11.40 per year, and all other customers are charged based on their water consumption each month. In Fiscal Year 2003 the City is projected to collect $6.03 million from storm drain fees. This revenue funds the routine maintenance and repair of the storm drain system, but not compliance with the City's NPDES permit. Other cities employ a storm drain fee as well. The City of Sacramento has a tiered rate storm drain charge, increasing with the number of rooms in each residential location. The rate for a unit with one to three rooms is $7.53 a month. In Fiscal Year 2000 Sacramento collected $27 million in storm drain fees.

Potential Impacts

The City of San Diego currently spends $29 million per year on storm water pollution abatement efforts. It is estimated that an additional $30 million in annual funding is needed to fully implement the City's Urban Runoff Management Plan. Furthermore, legislation signed by Governor Davis in March 2003 authorizes the State Water Resources Control Board to restructure their fee structure. Currently the City of San Diego pays $20,000 per year for the NPDES permit, which allows the City to operate the storm drain conveyance system (the current fee structure, based on population size, is capped at $20,000 for populations greater than 250,000). At this time, a new fee structure has not been proposed, but it is anticipated that the permit fee will increase and the structure will not be based solely on population.

Options

The General Services Department, Storm Water Pollution Prevention Program is currently working with the Mayor's Clean Water Task Force to identify potential alternative means of financing the actions necessary to comply with the municipal storm water NPDES Permit, No. CA0108758. In addition, the Storm Water Pollution Prevention Program is working with a consultant to ensure the alternatives being considered are in conformance with the requirements imposed by Proposition 218. It is anticipated that the work of the Task Force and the City's consultant will be completed within the next six to nine months, at which time the outcome will be presented to the Mayor and City Council.

TRANSIENT OCCUPANCY TAX

The Transient Occupancy Tax (TOT) is a tax imposed on persons occupying a room in a hotel, motel, inn, or other lodging facility for less than 30 consecutive days. The tax is levied as a percentage of the total rent charged to the occupant for use of the room. Revenue is collected by the lodging facility and then transferred to the City. Section 7280(a) of the State Revenue and Taxation Code permits the legislative body of any city or county to levy a tax for the permission of occupying a room in a lodging facility. Section 35.0101 of the San Diego Municipal Code establishes the imposition of the TOT.

How San Diego Compares

Currently the TOT imposed by the City of San Diego is 10.5 percent of room charges. This reflects a 1.5 percent increase that became effective in August 1994. Of this 10.5 percent, 5.5 percent is allocated to the General Fund and 5 percent is allocated for various promotional purposes through the Special Promotional Programs budget. The Fiscal Year 2003 TOT budget is $108.2 million. Of this amount, $56.7 million is budgeted for the General Fund, comprising approximately 7.8 percent of General Fund revenues.

Among the peer cities surveyed, San Diego's TOT rate is one of the lowest. In fact, only four cities have lower rates. Anaheim has the highest TOT rate at 15 percent, followed by Los Angeles and San Francisco, both with a rate of 14 percent. Five cities impose a rate of 12 percent.

The City of Santa Barbara recently passed a two percent increase in its TOT. Measure B, approved by voters in the year 2000, provided an increase in the TOT from 10 to 12 percent. The additional funding, as provided by the Measure, is restricted for use in the Creeks Restoration & Water Quality Improvement Program. In 1996 voters in the City of Anaheim approved a 2 percent increase in the City's TOT, from 13 to 15 percent. Additional revenues from the tax increase were earmarked for infrastructure improvements relating to Disneyland's expansion.

Potential Impacts

Increasing the transient occupancy tax may adversely affect tourism. If rates are set too high, tourists may choose to avoid the higher cost of lodging by visiting other locations. This effect could impact TOT and sales tax revenue, as reduced tourism could reduce local sales receipts as well. Given San Diego's relatively low TOT rate this is not a significant issue, but nonetheless should be considered prior to an increase in the TOT.

Options

Based on Fiscal Year 2003 budgeted receipts of $108.2 million, a 1 percent increase in the tax rate would yield approximately $10.3 million in additional revenue. A 2 percent increase in the tax rate would yield approximately $20.6 million. In 2001 the average daily rate for hotel rooms in San Diego was $110.79. Based on this figure, a 2 percent increase in the TOT would increase the cost to consumers by only $2.22. Such a marginal increase is unlikely to defer tourists to other locations. In addition, the impact of a transient occupancy tax increase to local residence is minimal, as tourists and business travelers generate the majority of TOT revenue. If a proposal to increase the TOT is considered, it is recommended that the City work with key stakeholders including the San Diego Hotel-Motel Association.

UTILITY USERS TAX

The utility users tax (UUT) is one of three separate categories of revenue related to public utilities, along with franchise fees and municipal transfers. The UUT is a tax imposed on the consumption of public utilities, including electricity, gas, cable television, water, and telephone services. The tax is charged as a percentage of the consumer's utility bill, which is then collected by the utility and remitted to the city.

How San Diego Compares

Along with four of its peer cities, San Diego does not currently impose a utility users tax. However, for some cities, it is an integral source of General Fund revenue. The City of Los Angeles levies a tax on users of electricity, gas, and telephone services. Charging a rate of 10.3 percent of total utility charges, the city received $489.4 million in Fiscal Year 2000, accounting for 12 percent of General Fund revenue. The UUT represents the second largest source of general fund revenue for Los Angeles behind property taxes. The City of Sacramento's 7.5 percent utility users tax generated $42.6 million in Fiscal Year 2000, accounting for 17 percent of General Fund revenue. Like the City of Los Angeles, the tax is the second largest source of Sacramento's General Fund revenue. The City of Long Beach collected $57.4 million in UUT revenue in Fiscal Year 2000, accounting for over 19 percent of General Fund revenues, the highest percentage of all peer cities. Long Beach's 10 percent tax on users of electricity, gas, telephone and water provided the largest source of General Fund revenue.

Despite these figures, the trend does not favor fiscal reliance on the utility users tax. Burgeoning electric and natural gas prices have spurred consumers and special interest groups such as the Howard Jarvis Taxpayers Association to petition local governments for reductions or elimination of UUTs. In the November 2000 election, residents of Long Beach voted to cut the city's UUT in half, reducing the tax 1 percent each year until it stands at 5 percent in 2004. However, in the recent November 5 election, Sacramento residents rejected a measure to cut the city's UUT to 2.5 percent from 7.5 percent over a four year period.

Potential Impacts

Because many utilities such as water and electricity are basic necessities, consumers will be forced to spend more of their after-tax income on utility charges if this tax is imposed. This could affect other types of consumer spending, harming the local economy and reducing revenues from other sources, such as sales tax. This type of tax is also considered to be highly regressive, meaning lower income residents will be forced to pay a larger portion of their income. In addition, UUTs could potentially impede San Diego's ability to attract new businesses, hurting the region's economic growth potential.

Options

The City of San Diego stands to gain considerable revenue by imposing a utility users tax. Assuming $15 per capita in tax revenue, the City could receive $18.5 million for each one percent in UUT. A majority vote is required to impose such a tax. Given the recent surge in electricity and natural gas prices, it is doubtful that voters would respond favorably to a tax that is assessed as a percentage of the total utility bill. Furthermore, any attempt to put forth a vote on imposing a UUT may be met with opposition from taxpayer advocacy groups such as the Howard Jarvis Taxpayers Association.

OTHER REVENUE SOURCES

The following sources of revenue are less well-known and less widely implemented compared to the sources that have been previously discussed. These potential sources are being investigated and analyzed by City staff. In a departure from the previous format, each one of these sources is described in a brief paragraph. It is recommended that further analysis be conducted as to the feasibility and potential revenue from these revenue sources prior to pursuing these potential sources.

Admission Tax

An Admission Tax is levied on admission fees charged for attending a variety of events, shows or conventions, including concerts, movies, athletic contests, bowling, night clubs, or displays of live animals and/or plants. The City of Philadelphia and the City of Santa Cruz both employ a five percent tax rate. A five percent Admission Tax in San Diego would generate approximately $4.9 million for the City's General Fund.

Paramedic Subscription Program

In an effort to enhance the City of San Diego's first-response capabilities to medical emergencies, the San Diego Fire-Rescue Department is developing a proposal to institute a voluntary first-response Paramedic Subscription Program similar to those used in Huntington Beach and Anaheim. Under this program, households and businesses would have the option of paying an annual subscription fee. Those who elect to pay the fee would not be charged if first-response medical service is required. Those who choose not to pay the voluntary subscription fee would be billed for emergency medical first-response. Transport fees would still be charged to all users when applicable.

Public Safety Property Tax Assessment

An additional Property Tax Assessment for public safety services could be levied on new development in the City. As proposed in the City of Elk Grove, California, for example, this tax would not be levied on current homes, only future development, and would be designed to increase with inflation. Service levels to the new developments would not differ from services to established communities. Because in most cases each new household costs a city more in services than it contributes in taxes, the City has been falling behind in its ability to recover the costs of basic services such as public safety. Based on new residential construction in 2001, a Public Safety Property Tax Assessment of $275 on each new dwelling unit would generate approximately $1.8 million in General Fund revenue.

Rental Car Tax
The Rental Car Tax is charged as a percentage of the daily rental rate of any passenger vehicle that is rented for less than 30 days. The tax is paid by the vehicle renter, and remitted to the City Treasurer by the rental operator. The rental car tax is often considered to be equivalent to the transient occupancy tax, since the burden of the tax falls most heavily on visitors. If the City of San Diego were to implement a 3 percent rental car tax, it could generate approximately $24 million for the General Fund. More research on this revenue option is needed to determine whether this is a viable option.

Retirement Tax
Under Section 76 of the City Charter, the City Council was authorized, if necessary, to levy an ad valorem tax in an amount sufficient to meet the requirements of the City's pension funds for public safety employees and general city employees. The City levied a retirement tax under this Charter section between 1961 and 1978. The City Attorney's Office is presently conducting a thorough analysis to determine the current status of the retirement tax provision, given both Proposition 13, and the more recent voter approval requirements imposed by Proposition 218.

Special Event Support
Council Policy 100-06 requires the City to provide support for special events conducted by non-profit organizations up to a maximum cost of $3,000. The City may provide support beyond $3000 for certain traditional City events. Special events may include parades, sports events, film making activities and many others. City staff is currently reviewing this policy and any proposed revision to the policy will be brought forward to the appropriate City Council Committee. This revenue source may be pursued for the Fiscal Year 2004 Budget.

Valet Parking Tax
The Valet Parking Tax is in addition to the Parking Lot Tax. Valet companies would be subject to the Parking Lot Tax as listed above, in addition to a tax on the hourly wages for the hired valets and any fee paid by the vehicle operator for the valet parking service. The City of Washington, D.C. currently employs a 12 percent Parking Tax, which extends to all aspects of the Valet Parking Business. Should the City of San Diego implement the 10 percent Parking Lot Tax as listed above, it should be extended to include all transactions associated with the valet parking business, including fees paid for space in a garage where valets park the cars, wages paid to valet drivers, and fees paid to valet drivers by vehicle owners.

6 to 6 Registration Fee
An annual Registration Fee would be charged to 6 to 6 member families not eligible for the Federal USDA Free Lunch Program. Families eligible for the Federal USDA Free Lunch Program would not be charged a fee. This would make this successful program more cost

recoverable while continuing to provide economical childcare services to local families. This revenue source may be pursued for the Fiscal Year 2004 Budget.

EXPENDITURE OUTLOOK

In the past, the growth rate of the major revenue sources has been reasonably sufficient to keep pace with some of the increasing needs for General Fund core services and programs. In recent years, however, inflationary increases and increases in other mandatory programs have eroded the General Fund surplus. Furthermore, a slow economy over the past two years has negatively impacted revenue growth, while demand for core services and programs continues to increase. In Fiscal Year 2004, General Fund expenditures are expected to be reduced by approximately $30 million in order to keep in line with revenue. If expenditures are needed to expand to meet out citizen's and City Council requests for services, then the General Fund revenue base will need to be enhanced to meet these requests.

CONCLUSION

This report is in response to Recommendation # 7 of the Blue Ribbon Committee Report by identifying and analyzing new sources of revenue and investigating the expansion of existing sources of revenue. Each source of revenue has been analyzed with regard to potential additional revenue, comparisons with peer cities, and potential impacts. If the City wants to pursue some of these major revenue enhancement opportunities, it is suggested that the City partner with community groups such as the Chamber of Commerce, the Taxpayers Association, Hotel-Motel Association, Convention and Visitor's Bureau, League of Women Voters, Economic Development Corporation, etc. to conduct forums to get input on revenue enhancement.

Relative to peer cities, San Diego has historically had a low per capita revenue base. Instead of increasing taxes and fees, the City has opted to reduce expenditures and focus on efficiency an effectiveness through Performance Based Budgeting and the Organization Effectiveness and Optimization programs. In order to obtain customer services at the City Council expected levels to fund core areas such as public safety, park and recreation, libraries, street maintenance, and deferred maintenance, the City of San Diego should consider implementing new sources of revenue.

Respectfully submitted,

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Lisa Irvine	Approved: Michael T. Uberuaga
Financial Management Director	City Manager

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Note: The attachment is not available in electronic format. A copy is available for review in the Office of the City Clerk.

Attachment A – Blue Ribbon Recommendation #7