

SHOW ME THE MONEY!

Enhanced Revenue Options for Cities

League of California Cities, Municipal Finance Institute
November 30, 2016



PRESENTED BY

William James (Jim) Priest
Sigrid Asmundson



Sources of Local Government Revenue

- Local Taxes - May either be:
 - General – Revenues may be used for any valid public purpose
 - Special – Revenues are legally earmarked for specific purposes
- Special Benefit Property Assessments
- Property-Related/Utility Fees (e.g., water, sewer, trash fees)
- Development Impact Fees (e.g., AB 1600, Quimby Act)
- Operational Fees (e.g., application/permit fees, admission fees, copy charges, park program fees)
- Fines and Penalties
- Transfers from other government agencies



Types of Local Taxes

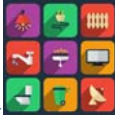
- Transient Occupancy/"Hotel" Tax (TOT)
 - Set as a percentage of "rent" charged to the hotel guest
 - Typically limited to stays of 30 days or less (charter cities can go longer)
 - Emerging Issues – Most TOT ordinances based on 1970's model
 - Online travel company ("OTC") litigation:
 - OTC's only remitting TOT based on "wholesale" room price, not marked-up "retail" price charged to customers/occupants
 - Outdated definitions of "operator", "rent" and "occupant"
 - Nationwide litigation pending – billions of \$5 at stake
 - California litigation consolidated at Calif. Supreme Court – decision in early 2017
 - If decision goes against cities, consider updating your ordinance
 - Online short term rental companies ("OSTRC's"):
 - Most ordinances do not address online services like AirBNB, VRBO, etc.
 - OSTRC's claim they are only "brokers", and "hosts" do not collect TOT from "guests"
 - Consider updating your ordinance
 - Alternative? – AirBNB doing collection agreements with some cities (but not a perfect solution)
 - Updating ordinance likely requires election under Proposition 218



Types of Local Taxes

• Utility Users Tax (UUT)

- Local excise tax on privilege of using utilities such as water, telecom, TV/video, electricity, gas, sewer and trash
- Set as a percentage of utility charges to the customer/user
- Emerging Issues – Original UUT ordinances based on 1980's model
 - Outdated FET exemption – if Telecom service exempt from FET, it's exempt from UUT
 - Exemption based upon land-line era telecom technology
 - 2006 – IRS announces all long-distance wired & wireless telecom exempt from FET
 - Outdated reference exempts same services from UUT = Major loophole
 - Several cities currently in UUT class action refund litigation
 - Many California cities have already updated language – Has your City?
 - Video Services – Outdated language based upon “cable TV” model
 - Doesn't address modern internet-based on-demand video services (Netflix, Hulu, etc.)
 - Even with modern ordinance, controversy over administrative ruling to cover these services (Pasadena)
- Updating ordinance likely requires election under Proposition 218



Types of Local Taxes

• Transactions and Use Tax (TUT)

- Commonly known as “sales tax,” applies to retail transactions of personal property and to storage, use, or consumption of personal property purchased from any retailer
- Combined county-wide rate cannot be > 2% above state base sales tax (7.5%), unless city/county has special legislation to exceed this cap
- Administered by the State Board of Equalization via contract with City
- Emerging Issues:
 - Several cities at or close to 2% TUT cap (rise in special legislation to exceed cap)
 - BOE silent on concurrent TUT's that, if adopted, would increase total over 2% cap
 - AB 464 to increase TUT cap to 3% vetoed by Governor (2015)
 - “Point of Sale” - TUT applied to any retailer with “substantial nexus” in California
 - Sales tax on Internet purchases depends on seller's nexus to CA
 - Digital products are non-taxable



Types of Local Taxes

• Parcel Tax

- A tax on the privilege of the availability of municipal services
- Must be adopted as special tax unless City can show tax is unrelated to the parcel or a person as an incident of property ownership
- Only statutory exemptions allowed
- Emerging Issues:
 - Caps or other restrictions on parcel taxes based on square footage
 - Potential exemptions?



Types of Local Taxes

- Other Local Taxes
 - Marijuana Taxes
 - Gross Receipts tax as high as 20% (Santa Barbara)
 - Tax per-square-foot on marijuana cultivation for commercial purposes (Calaveras County)
 - Tax Medical and Recreational Marijuana in light of Proposition 64?
 - Business License Taxes
 - Parking Taxes
 - Admissions Taxes
 - Payroll expense or occupational privilege tax
 - CFD Special Taxes
 - "Not to Exceed" Taxes
- Charter Cities' "Home Rule" authority to levy taxes for general revenue purposes could supersede limiting State law



BBK
BENT BENT & KUBIEGER
ATTORNEYS AT LAW

Procedure for Local Taxes

- Proposition 218 (Calif. Const. Art. XIII C – 1996)
 - Requires voter approval of any new, increased or extended local tax
 - General tax – simple majority voter approval required (50% + 1)
 - Special tax – 2/3 supermajority voter approval required (66.7%)
 - "Increase" = changing rate or methodology resulting in higher tax
 - Tax measure may be placed on ballot by City Council
 - Must be called not < 88 days prior to election day
 - To place a general tax on the ballot, special rules apply:
 - For most cities - 2/3 Council vote required to call measure
 - Charter city – simple majority OK if charter expressly says so (if charter silent, need 2/3 Council vote)
 - TUT always requires 2/3 Council vote to put on ballot
 - Measure must be consolidated with regular Council election unless Council unanimously declares "emergency" justifying earlier election
 - These rules don't apply to special tax measures



BBK
BENT BENT & KUBIEGER
ATTORNEYS AT LAW

Procedure for Local Taxes

- Tax measure may also be proposed by citizens' petition
 - Lower signature threshold than for typical measures (5% of actual voters at last gubernat'l election rather than 10% of registered voters)
- Election held like other initiative measures
- If passed, some taxes have delayed effect
 - TUT – 4-6 months; UUT - 60-90 days
- Repeal or Reduction of Local Taxes
 - City Council may delay, repeal or reduce taxes without an election
 - Be careful – this can be a "one-way door" – election may be required to undo it
 - Citizens have right to propose repeal or reduction of taxes by petition
 - Same reduced 5% signature requirement under Proposition 218
 - If enough signatures gathered, Council may repeal or reduce tax as proposed or put issue to the voters (like other initiative measures)

BBK
BENT BENT & KUBIEGER
ATTORNEYS AT LAW

Special Benefit Assessments

- Examples:
 - Landscaping and Lighting District assessments;
 - Business Improvement District assessments;
 - Utility standby charges (but not rates/charges for actual use)
 - Not code enforcement/abatement assessments/liens
- Proposition 218 limits what may be assessed
 - Only "special benefits conferred upon real property" may be assessed
 - "Special benefit" = a **particular and distinct benefit** over and above general benefits conferred on real property located in the City or to the public at large."
 - City-wide assessment districts suspect – "If everything is special, then nothing is special."
 - General enhancement of property value ≠ "special benefit."



Special Benefit Assessments

- Procedure to adopt new or increased assessment
 - Consult applicable Assessment Act as well as Proposition 218
 - Any conflicts? Proposition 218 (Calif. Const. Art. XIII, §4) and Proposition 218 Implementation Act (Govt. Code §53750 et. seq.) govern
 - Assessment must be supported by a **detailed** report prepared by a State-certified engineer. Report must:
 - Identify all properties receiving special benefit;
 - Separate out general from special benefits;
 - Calculate assessment amount for each identified parcel;
 - Determine proportionate special benefit in relation to entire cost of improvements and/or services funded by special assessment;
 - No assessment shall exceed proportional special benefit conferred on that parcel



Special Benefit Assessments

- Assessment report may not exclude properties receiving special benefit from assessment district – this causes other properties to pay \$\$ that exceed their special benefit
- No "reverse engineering" of assessments - Value of "special benefit" to property is the driver, not budget \$\$ or general costs

NOTE: Review the report carefully with City Attorney. Faulty reports are where most litigation (and adverse decisions) have come from!

City has burden of proof to show compliance. Deferential standard no longer applies.



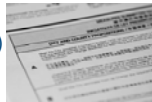
Special Benefit Assessments

- Assessment procedure
 - Mail notice to record owners not < 45 days prior to the public hearing
 - Notice must include: amount and basis for assessment; a sealable ballot for the owner to return; information about how ballots are processed and tabulated; statement that "majority protest" will defeat assessment; date/time/location of hearing; etc.
 - Council conducts public hearing - Ballots may be submitted, changed or withdrawn prior to close of hearing
 - Ballots remain sealed until close of public hearing (no pre-counting)
 - After hearing closed, impartial person (usually City Clerk) opens and tabulates ballots (typically a public process)
 - Ballots "weighted" according to owner's proportional assessment
 - If weighted "No" ballots > "Yes" ballots, there is a "majority protest" and assessment fails. If vice versa, Council may adopt assessment
 - Once opened, ballots and "weighting" information are public records. Ballots must be preserved for not < 2 years (no "secret" ballots)



Property-Related Fees

- Proposition 218 (Calif. Const. Art. XIII D, §§2 & 6) governs new/increased property-related fees
- "Property related fee" is charged to a parcel or person as an "incident to property ownership", including fee that pays for a public service having "a direct relationship to property ownership"
 - Tenants directly liable for fee/charge included in "property ownership"
- Examples of property-related fees:
 - Water, sewer, stormwater and trash fees/charges



Property-Related Fees

- Procedure for new or increased property-related fees:
 - Mail notice to "record owner" (who may only be a fee-paying tenant) not < 45 days prior to the public hearing.
 - Notice must include: amount, reason & basis for fee; date/time/location of hearing
 - Not required to include "majority protest" procedure or a written protest form
 - OK to mail notice to customer of record by including in regular billing statement or by any other mailing to the customary billing address
 - But, if City intends to enforce lien for fees, must also mail to property owner, if different from the customer's address
 - Council conducts public hearing - Written protests may be submitted, changed or withdrawn prior to close of hearing
 - Pre-counting of written protests OK (but ensure document security)
 - Only written protests count towards a "majority protest" (e-mails?)
 - No "weighting" of protests – one protest per parcel
 - Written protests must be preserved for not < 2 years after hearing

Property-Related Fees

- If majority of parcels subject to fee submit written protests (“majority protest”) the fee fails. If vice versa, Council may adopt the fee
- Unless authorized by other law or charter, water, sewer or trash fees must be approved by a 2/3 vote of the City Council
- For water, sewer and trash fees, “majority protest” procedure is all that is required to approve (“Baby 218”)
- All other property-related fees (e.g., stormwater) must subsequently be either:
 - Approved by majority of the property owners subject to the fee, or
 - Approved by a 2/3 vote of the electorate in the affected area (the City)
 - Property owner ballot conducted like an assessment ballot proceeding (see above)
 - Voter election conducted like any other local initiative measure election



Property-Related Fees

- For water, wastewater, sewer and trash service, City may set a schedule of automatic fee adjustments without another Proposition 218 process, provided:
 - Schedule may not exceed 5 years;
 - Must include “clearly defined formula” for inflation (e.g., CPI, PPI);
 - May include pass-through increases or decreases in wholesale water, sewer or wastewater charges imposed on the City;
 - May never exceed costs of providing the service;
 - Must send written notice by mail to the “record owner”/customer not < 30 days prior to each adjustment (e.g., postcard in May monthly bill)



Property-Related Fees

- Proposition 218 sets substantive limits. Fees may. . . .
 - Not exceed funds required to provide property-related service;
 - Not be used for any other purpose;
 - Not exceed proportional cost of service attributable to specific parcel charged (no “cross-subsidies”);
 - Only be imposed for service that is actually used by, or immediately available to, the property owner. Standby charges = assessments;
 - Not be imposed for general governmental services (e.g., police, fire, ambulance or library services) if available to the public in same manner



Property-Related Fees

- Some general takeaways:
 - Fees may pay for both capital and operational costs of property-related service
 - Transfers of fee revenue to General Fund OK if reimbursing General Fund for services provided to support the utility (e.g., borrowing city staff time and equipment)
 - Tiered rates OK only if based upon increased cost of service in higher tiers. Conservation-based tiered rates not OK
 - City has burden of proving compliance. Establish a solid record that fees are proportional and do not exceed costs of providing service
 - Include both a narrative and mathematical explanation



Property-Related Fees before State Reimbursement

- State must reimburse cities for costs associated with new program or higher level of property-related service mandated by the State



- BUT, if City can seek property related fees to cover State mandated costs, City must do so and be rejected by affected owners before seeking State reimbursement



Development Impact Fees

- Mitigation Fee Act (Govt. Code §§66000-66018)

- Authorizes imposition of impact fees as a condition of development project approval in order to defray all or part of the cost of public facilities related to the project



- Examples – Police, Fire, Streets/Traffic, Parks, Water, Sewer, Stormwater Impact Fees

- Fees may only be used to fund future capital improvements required by new development, not fix existing deficiencies



Development Impact Fees

- Must be supported by data which does the following:
 - Identifies purpose of the fee;
 - Identifies use to which the fee is to be put;
 - Determines reasonable relationship between the fee's use and the type of project on which the fee is imposed;
 - Determines reasonable relationship between the need for public facilities and the type of project on which the fee is imposed;
 - Determines reasonable relationship between fee amount and cost of public facility attributable to the project on which the fee is imposed

NOTE: This is the major work. Many cities retain a consultant to assist in preparing an impact fee report with supporting data



Development Impact Fees

- Procedure:
 - Publish notice of hearing twice, first pub. not < 10 days prior to hearing
 - Notice must provide date/time/location of hearing, a general matter description, and statement that supporting data is available to the public.
 - Mail same notice to persons requesting fee notices, not < 14 days prior
 - Make supporting data publicly available not < 10 days prior to hearing
 - Hold the public hearing – no “majority protest” or similar process
 - Fees become effective 60 days later
 - Typically collected at building permit or certificate of occupancy
 - Fees must be deposited in a separate capital facilities account
 - City must annually account for fees and expend fees within 5 years after collection (except if “saving up” for large publicly-disclosed project)



Other Development-Related Fees

- Water and sewer connection charges, capacity charges, and most zoning, land use and building application fees subject to same notice and hearing procedure
- City must provide data/report justifying that fees/charges do not exceed reasonable costs of providing facilities/services. Level of detail will depend upon the fees/charges in question



- Are your development impact fees current?
- Are your zoning, building, etc. fees current?

Taxes, Assessments & Fees Cannot Be Repealed By Referendum

- *Ebinger v. Yorba Linda Water District* (2016, unpublished)
 - Increase of monthly water rates as an urgency measure to offset a decline in revenues during the drought is not subject to repeal through the referendum process
- *Howard Jarvis Taxpayers Ass'n v. Amador Water Agency* (2016, appeal pending)
 - Tax levies (including fees and charges) not subject to referendum
- However, taxes/assessments/fees may be repealed or reduced by initiative

Proposition 26 (Calif. Const. Art. XIII C, §1)

- Adopted in 2010 in reaction to perceived abuses of “regulatory fees” exceeding costs of actual regulation (*Sinclair Paint* case)
- Defines a “tax” to mean “any levy, charge or exaction of any kind imposed by a local government, except the following”:
 - A charge imposed for:
 - a specific benefit/privilege conferred directly to the payor and not to others, and which does not exceed the City’s reasonable costs of conferring the benefit/privilege;
 - a specific service or product provided directly to the payor and not to others, and which does not exceed the City’s reasonable costs of providing the service/product;
 - City’s reasonable regulatory costs for issuing licenses/permits, investigations, inspections, and audits, and administrative enforcement/adjudication thereof
 - entrance to or use of City property, or the purchase, rental, or lease of City property
 - A fine, penalty, or other monetary charge imposed by a court or the City, as a result of a violation of law
 - A charge imposed as a condition of property development
 - Assessments and property-related fees imposed pursuant to Article XIII D (Proposition 218)

Proposition 26 (Calif. Const. Art. XIII C, §1)

- If a “fee” is deemed a “tax”, requires voter approval (majority if a general tax and 2/3 supermajority if a special tax)
- Pre-November, 2010 fees are grandfathered (but amendment or reauthorization of fees will be subject to Prop. 26)
- Burden is on public agency to prove “fee” is not a “tax” – so establish a firm administrative record that a Prop. 26 exception applies



Thank you for attending

William James (Jim) Priest
Of Counsel
Best Best & Krieger LLP
Ontario Office
(909) 989-8584 (main)
(909) 483-6648 (direct)
Email: william.priest@bbklaw.com



Sigrid Asmundson
Of Counsel
Best Best & Krieger LLP
Sacramento Office
(916) 325-4000 (main)
(916) 551-2853 (direct)
Email: sigrid.asmundson@bbklaw.com