

Mayor's Advisory Task Force
City Revenue

Report to the Mayor
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Members of the Task Force

Dion Aroner, Chair

Jimmy Bryant

Dennis Cohen

Russ Ellis

Anne Henderson

Eric Leenson

Dan Lindheim

Jay Miyazaki

Charles L. Robinson

Rev. Kim Smith

Cynthia Wooten

Special thanks to: Phil Kamlarz, Paul Navazio, Arrietta Chakos, Tom Myers, Heather Murphy, Dave Fogarty, Barbara Gilbert, Susan Kupfer, and many others.

Executive Summary

With the city facing a growing deficit of at least \$16 million by 2008, Mayor Tom Bates convened a Task Force to examine how to deal with this looming budget crisis. In nine meetings, this group of Berkeley residents heard from experts in city finance, public opinion, economic development, and other areas.

➤ Findings

In comparison to the magnitude of the budget crisis facing the federal and state governments, Berkeley has taken prudent action to manage the recent economic downturn and budget shortfall. Nonetheless, the City's General Fund is expected to experience another \$8 million deficit in the next fiscal year. With shortfalls in special city funds for paramedic and other services, that deficit will climb to over \$9 million.

With the growing likelihood of massive cuts in state funding, the City will no longer be able to protect front line services. State cuts currently being discussed would add at least \$6 million to Berkeley's deficit next year alone. All together, the City may face more than a \$15 million deficit next year.

Without additional revenue, Berkeley will have to make major cuts into the core of city services – from social services to the fire department. Unfortunately, the City has few revenue raising options. Of options currently available, only a parcel tax raises significant revenue.

➤ Recommendations

The Task Force unanimously agreed that the City should adopt a balanced strategy of new revenue and expenditure reductions to close the budget gap. The specific recommendations are as follows:

1. The city balance its budget with a “balanced” approach that includes both cuts and tax increases. As part of this approach, the city should present a plan for a balanced budget for the next five years.
2. The city should place a \$10 million parcel tax measure on the ballot (equal to roughly \$250 per year for an average sized house). The measure should include a 5-year sunset provision, a citizen's oversight committee, and level-of-service guarantees.
3. The March 2004 primary election is the most appropriate time to place the measure on the ballot.
4. The city should engage in a serious education campaign to explain the budget issue to its residents.

In addition to these immediate recommendations, the Task Force made several longer-term recommendations to help stimulate the economic base. These longer-term recommendations include:

5. The City should seriously explore other revenue options to alleviate the unintended consequences of the parcel tax, including the car tax and a payroll tax.
6. The City should aggressively pursue greater cost recovery from UC Berkeley, Lawrence Berkeley National Laboratory, and other major non-profit organizations.
7. The City should aggressively pursue state and federal funding.
8. The City should more aggressively pursue economic development. The Mayor should take the lead in promoting greater commercial development in appropriate areas.
9. The City should match its tax policy with its planning policy.

Introduction

This is a budget season with no easy answers.

California faces the worst budget crisis in its history, a deeply divided legislature, and a new governor with no experience. The federal government has an unprecedented \$500 billion deficit of its own.

In comparison to the magnitude of the budget crisis facing the federal and state governments, Berkeley has fared better. Prudent and timely action has so far protected city services from the economic downturn and reductions in state funding. A hiring freeze and other measures helped cushion the \$6 million in cuts already made by the City. In addition, Berkeley's bond rating remains among the highest of any city in California – saving us millions in interest payments.

But with at least another \$9 million deficit next year and the likelihood of massive cuts in state funding, the City is no longer able to protect front line services. Without additional revenue, Berkeley will have to make major cuts into the core of city services – from social services to the fire department.

Facing this bleak picture, Mayor Tom Bates convened a group of Berkeley residents to examine how the city might meet this budget crisis. This group was made up of a broad spectrum of Berkeley residents – from business owners to a UC Berkeley undergraduate.

Through nine meetings, Task Force members heard from experts on city finances, economic development, and public opinion. The Task Force debated tax options, tossed around ideas on business development, and worried about the impact of additional taxes on homeowners and small businesses. (Agendas and meeting notes are available at the Mayor's website, www.ci.berkeley.ca.us/mayor.)

There were no easy answers. But, through this discussion, three salient points emerged. First, Berkeley has done a good job managing its budget. While other cities have laid off workers and slashed services, Berkeley has maintained services and balanced its budget. Second, the budget deficit is mostly the result of state action. While Berkeley's sales tax revenues are down, they are better than most of our neighbors. The biggest problem is that the state-run employee retirement system is requiring far larger city benefit contributions than had been projected. Third, Berkeley anticipates even larger cuts when the state budget balanced next year. In particular, the Task Force expects the Vehicle License Fee to be reduced by legislative action or by initiative.

In the end, the Task Force came to unanimous agreement that Berkeley cannot just cut its way out of this deficit. The recommendations for new revenue follow.

Findings

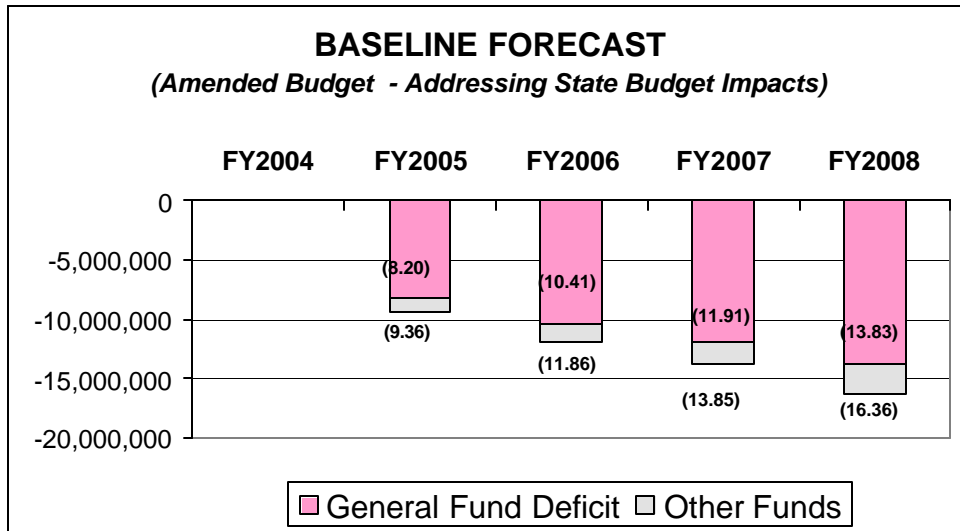
The Task Force based its recommendations on information provided over the course of its nine meetings. The presentations included detailed breakdowns of city revenue streams and the impact of various tax options. This information is summarized in this “findings” section to provide context for the recommendations that follow.

1. The City has taken early and prudent steps to manage its budget, but still faces a significant, ongoing budget deficit.

The City Council approved upwards of \$6 million in budget reductions to balance its 2003-04 budget. The latest round of reductions were developed by internal discussions with the City staff, reviewed and approved by the City Council numerous budget workshops and public hearings last spring and summer.

Despite these efforts, many unresolved budget issues cloud the deficit situation—current employee labor contracts were negotiated when the economic climate was more positive; costs associated with Workers’ Compensation claims continue to be significant; and, many City special funds are not covering program costs.

Next year, the general fund deficit will reach \$8.2 million and then grow by 1.5 to 2 million every year after that. Deficits in other fund would add an additional \$1 – 2 million to that deficit. The City has approved many cost-saving measures: a selective hiring freeze; reductions in the City fleet vehicles; reduced travel expenses; and eliminated unneeded telecommunications equipment.



2. The state budget crisis is expected to dramatically worsen Berkeley's financial picture.

Over the last twenty-five years, the state government has deeply eroded the local government funding base as Sacramento shifted funds typically assigned to cities to cover state funding needs. The municipal revenue pool was significantly reduced in 1978 by State Proposition 13 's reduction in property taxes. Subsequent legislation in the 1980s and 1990s exacerbated the deteriorating municipal fiscal situation.

- The ongoing budget crisis in Sacramento is likely to further reduce City funding. The Vehicle License Fee (VLF) monies are likely to be cut, either by a March '04 voter initiative ballot measure or by the Governor. Berkeley receives approximately \$6 million annually from the VLF fund.
- State-required City contributions to CalPers (the state-run employee retirement system) have increase far in excess of projections. This will cost the City an additional \$6 million per year.

3. Voters in Berkeley appear to support increasing taxes to avoid service reductions.

A voter survey was undertaken to gauge what Berkeley residents thought about a variety of fiscal issues, including new taxes and other revenue. The results of the recent voter survey conducted by David Binder and Associates indicate that Berkeley voters are opposed to reductions in City services and are willing to pay increased taxes in order to avoid service cuts.

4. The Parcel Tax is one of the few revenue options available to the City.

City governments are limited in the types of revenue increases they can pursue. State Proposition 218 (1996) strictly limits the City's capacity to raises taxes or fees, requiring a two-thirds voter approval rate on most tax or assessment measures. (Only a "General" tax – one in which the funds go directly to the city's general fund without any specific use – can be passed by simple majority vote. Those tax measures must be placed on the November general election ballot. Such taxes have a very poor track record in recent Bay Area elections.)

The Task Force examined a number of mechanisms for increasing local funds. Both special and general taxes were analyzed as potential ways to provide sufficient funds to keep City services at acceptable levels, balancing bud get cuts with new funding. Typically, the City has used voter approval of special taxes as the most frequent means to raise local monies.

A number of potential options were examined.

- Income Tax – Prohibited by state law.

- Property Tax (based on assessed value) – Prohibited by state law.
- Parcel Tax (based on square footage of “improvements”) – Available. Easy to collect and enforce.
- Sales Tax – Prohibited by state law.
- Admissions Tax – Prohibited
- Employee License Tax – Potentially available, but would be challenged in the courts and lacks a collection mechanism.
- Utility Users Tax – Available. Currently set at 7.5%. However, voters surveyed found this to be the least preferable of the tax options.
- Transient Occupancy Tax – Known as the “hotel tax” this is available and currently set at 12%. Increasing this tax does not raise much funding and Berkeley’s rate is already tied for the highest rate in the Bay Area.
- Parking Lot Tax – Available. Currently set at 10%. Increases in this tax also do not raise much revenue.
- Car Tax (for more than one car at a household) – Potentially available, but would be challenged in court and lacks a collection mechanism.

Based on these findings, the Task Force made the recommendations detailed in the next section.

Recommendations

To reach their final recommendations, the Task Force focused its debate around four questions. The questions were as follows:

1. What is the appropriate balance of cuts versus new revenue?
2. What type of new revenue should be raised?
3. If this new revenue requires a ballot measure, when should it be on the ballot?
4. What general strategy recommendations does the Task Force want to include?

The answers to those questions – all agreed to unanimously – form the basis of the recommendations now being submitted to the Mayor. These recommendations are broken into two sections. The “Immediate Recommendations” are designed to assist the Mayor in his efforts to make decisions about what to place on the ballot next year. The “Long Term Recommendations” are related to structural and other changes that do not need to be addressed immediately.

Immediate Recommendations

- 1. The Task Force recommends that the city balance its budget with a “balanced” approach that includes both cuts and tax increases. As part of this approach, the city should present a plan for a balanced budget for the next five years.**

While the poll results showed city voters were willing pay to increased taxes to avoid any significant service cuts, the Task Force recommends against relying entirely on tax increases.

Despite the size of the deficit and the likelihood of large cuts in state funding to local government, the Task Force recommends that tax increases be limited to \$10 million. The Task Force felt there were limits to what could be asked of Berkeley taxpayers. The Task Force recommendation is that additional budget balancing measures be spelled out so voters have a complete picture.

The Task Force also strongly recommends that any tax measure be presented with a detailed plan showing how the City will balance its budget for the next five years. While state cuts may require later changes to those projections, the City should commit to a 5-year balanced budget based on the current shortfall.

One of the most difficult issues before the Task Force was that of the employee labor contracts. Those contracts, when negotiated, were at the median for pay and benefits in the Bay Area. However, as the economy and state budget crisis have worsened, those labor contracts have grown relatively more expensive to the City. Currently, labor costs are growing faster than revenue. The Task Force recommends that the union leadership and city officials work constructively

together to find labor savings. Without such savings, the city will face additional deficits every year for the next five years.

2. The Task Force recommends placing a \$10 million parcel tax measure on the ballot. The measure should include a 5-year sunset provision, a citizen's oversight committee, and level-of-service guarantees.

The Task Force recommends a parcel tax that would raise \$10 million. This would require a tax increase of \$250 per year for an average sized house. After examining a number of other tax options, the Task Force decided that only the parcel tax provided adequate immediate revenue to the city. Some alternative tax options, including the business license fee and the hotel tax, raised too little money. Others, like the payroll or car tax, lacked collection mechanisms. (See long term recommendations below for more about alternative tax options.)

The Task Force also recommended that this parcel tax be accompanied by the following:

- **Sunset provision.** Under this provision, the tax would expire in 5 years unless reauthorized by the voters.
- **Exemption for low-income homeowners.** Homeowners with low-incomes should be exempted from this new tax. Such an exemption is in place for some of the other parcel taxes and should be extended to this one as well.
- **Service guarantees.** The voters should know they are getting something for their money. The Task Force recommends that the tax have clearly defined service guarantees – a specific level of social services or fire coverage, for example. The Task Force did not come to consensus on the type of service that should be guaranteed.

3. The Task Force recommends placing the new tax measure on the March 2004 primary election ballot.

While the November 2004 election promises to have high interest and a high voter turnout, the Task Force recommendation is to place this parcel tax measure on the March 2004 ballot.

First, a March election will allow city budget officials to prepare the 2004-05 fiscal year budget knowing whether there is any additional revenue available. A November election would require passing two budgets – one if the measure passed and a second that implements massive cuts in the event that it doesn't.

Second, the November 2004 ballot promises to be a full one with statewide bond measures for schools and high-speed rail, a local Berkeley school parcel tax, and other items. The Task Force was concerned that the City's measure may be drowned out by all the competing requests for funding.

4. The City must engage in a serious education campaign to explain the budget issue to its residents.

The information provided to the Task Force changed opinions about the work being done by the city and the nature of the budget problem. This changed understanding led to a strong recommendation by the Task Force that the city engage in a strong education campaign to explain city operations and budgeting to residents.

Long Term Recommendations

5. The City should seriously explore other tax options to alleviate the unintended consequences of the parcel tax.

The parcel tax has clear advantages. It is efficient to administer, simple to estimate, and understandable to voters. In addition, moderate increases in the tax can raise significant revenue. However, the tax has shortcomings. While city services are used by all residents, employees, and visitors to the city, only homeowners pay the parcel tax. In addition, voters in the most recent city poll found strong support for other types of taxes – including a payroll tax and car tax.

There are administrative and other hurdles to these other types of taxes that must be overcome. It is the Task Force's recommendation that city staff to engage in a serious investigation of these other tax options. One possibility is that the City Council place advisory measures on the November ballot to gauge the willingness of the voters to support these different types of taxes.

6. The City should aggressively pursue greater cost recovery from UC Berkeley, Lawrence Berkeley National Laboratory, and other major non-profit institutions.

While UC Berkeley and Lawrence Berkeley National Laboratory provide substantial economic benefits to the City, they also use a substantial amount of city services. Unlike private entities, these institutions pay no property tax or other service fees. The Task Force strongly supported the efforts of the City to pursue greater cost recovery efforts from such institutions, or regular in lieu of tax payments, as a matter of basic fairness to Berkeley taxpayers.

7. The City should aggressively pursue state and federal funding.

While both state and federal funding sources are limited due to the deficits in Sacramento and Washington, the Task Force recommended that the City should aggressively pursue any potential funding option. These include applying for state bond funding, state social service and public safety grants, federal transportation project funding, and other sources.

8. The City should more aggressively pursue economic development. The Mayor should take the lead in promoting greater commercial development in appropriate areas.

Economic Development can help alleviate the long-term budget shortfall by bring more business to Berkeley. Every dollar earned through business transactions is one less that need be raised by taxing residents. The sales tax, business license fee, and commercial property tax generated by economic activity is a win-win for Berkeley. The Task Force recommends that special efforts be made to develop the downtown area and other potential commercial corridors.

The Task Force recommends that the Mayor take the lead in efforts to envision possible development downtown and in other potential areas.

9. The City should match its tax policy with its planning policy.

In several areas, city tax policy does not appear to coordinate with planning policy. While this outside the purview of the Task Force, the potential conflict became clear during Task Force discussions. In particular, the commercial tax structure appears to be a strong disincentive for the types of manufacturing businesses envisioned in the West Berkeley plan.

The Task Force recommends that future planning efforts –including eventual revisions to the West Berkeley Plan and the General Plan – review the impact of these tax policies to ensure the City are not working a cross purposes.