



## Legislation Text

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**File #:** 15-0036, **Version:** 1

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**TO:**

Honorable Mayor and Members of the City Council

**THROUGH:**

Mark Danaj, City Manager

**FROM:**

Bruce Moe, Finance Director

**SUBJECT:**

Results of Preliminary Studies of Updated Storm Water Utility Fees and Landscape and Street Lighting Maintenance District Assessments; Revenue Measure Feasibility Study Survey Report; Information on Potential General Fund Revenues (Finance Director Moe)

**DISCUSS AND PROVIDE DIRECTION**

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**RECOMMENDATION:**

Staff recommends that the City Council receive presentations, and discuss and provide direction on the preliminary studies (including survey results) for the Storm Water funding and Street Lighting and Landscaping District funding, as well as information regarding other General Fund revenues.

**FISCAL IMPLICATIONS:**

Both the Storm Water and Street Lighting & Landscape District funds have no fund balance and operate at a deficit. Further, over the next five years, General Fund subsidies of these funds are projected to total approximately \$7 million (including unreimbursed support costs incurred in the General Fund). These subsidies draw resources away from other important General Fund needs as well as diminishing the City's ability to fund certain general capital improvement projects.

Additionally, while yet to be fully identified, the costs of compliance with the National Pollution Discharge Elimination System (NDPES) will certainly add significant costs to the Storm Water utility in the coming years, which may require further fee increases in order to fund these federal mandates.

Fiscal implications are discussed further later in this report.

**BACKGROUND:**

The City established separate funding sources for Storm Water activities (1995), as well as Street Lighting and Landscaping districts (SLLD, 1972). These funds segregated the activities from the General Fund, and included dedicated revenue sources to pay for the services provided. In the case of Storm Water it is a fee collected on parcels based on a 1996 independent study by the firm of Kennedy Jenks, which allocated costs based on storm water runoff factors for each parcel. An assessment is collected for SLLD which is designed to cover the costs of operations (including energy costs) and maintenance of street lights. Both the fees and assessments are land use based and are collected through the annual property tax bill (even though these are not taxes).

Like other enterprise funds (water, wastewater, parking, etc.), Storm Water and SLLD funds are designed to be self-sustaining (e.g., fees and assessments sufficient to provide the service and maintain adequate reserves). However, these activities are not adequately funded; neither the Storm Water fees or the Street Lighting and Landscaping District assessments have been changed since 1996 (pre Proposition 218), while at the same time costs have risen, and mandates have been imposed. As a result, the General Fund is subsidizing both activities.

Given the aforementioned structural imbalances in the Storm Water and Landscaping and Lighting funds, the City Council authorized preliminary studies of increased fees/assessments. Through a competitive process, the firm of Harris and Associates was retained to conduct the studies, which also included a survey on the community's capacity for increased fees. Please see Attachment #1 for the initial staff report on funding options for Storm Water and Street Lighting and Landscaping Districts.

### **DISCUSSION:**

Attached to this staff report are the preliminary studies as well as the survey results. Staff recommends that City Council read those reports as a basis for the discussion at the Study Session. Dennis Anderson of Harris and Associates will present the information contained in the reports at the Study Session, and will be available for questions.

By way of a high level overview of the reports, the following summarizes the increased fees as determined by Harris and Associates:

#### *Storm Water Analysis (Attachment #2)*

Currently, typical single family residence (SFR) owners are charged \$19.12 per year for Storm Water services. These parcels, as well as non SFR housing, commercial properties, and school district properties generate approximately \$350,000 per year. The estimated annual costs of the Storm Water system for analytical purposes was the FY 2014-2015 operating budget and a placeholder for capital improvement projects of \$1 million. The total theoretical cost equals \$2,488,545.

Using standard methodology, Harris and Associates engineers developed a technique to allocate those costs (\$2.49 million) based on size, use of parcel and runoff factors. The allocation tool is referred to as the Drainage Measurement Unit, or DMU. Full cost recovery would result in a maximum first year fee for each DMU of \$191.80. A parcel of .08 to .14 acres (3,500 square feet to 6,100 square feet) equates to 1 DMU. Parcels with fewer than 3,500 square feet carry a DMU of 0.791789, while larger parcels may have DMUs of 13-14.

These DMUs are multiplied by the \$191.80 fee to arrive at the annual maximum fee for the first year (which may be adjusted by the Consumer Price Index thereafter if approved by voters). The results of these calculations are shown on Table 4 of Attachment #2 - the Storm Water Utility Fee Preliminary Analysis. First year fees based on the DMUs would range from a low of \$151.87 per year to a high of \$23,061.51.

#### *Street Lighting and Landscaping Districts (Attachment #3)*

Street lighting charges across the City vary based on the type of lighting (standard, gas lamp, Strand,

etc.) as well as the type of use (single family, condo, etc.). Current charges range from a low of \$2.70 for vacant residential walk street to \$208.99 for a triplex in the Gas Lamp area. A typical single family residence (SFR) with standard street lighting pays \$17.03 per year. These assessments have not been changed since 1996.

The preliminary analysis by Harris and Associates calculates the fee required for a SFR with standard lighting (Zone A) at \$38.79 (an increase of \$21.76 or 128%). Further, the Landscaping and Lighting District assessments for SFR within each identified zones would increase as follows:

<u>Description</u>	<u>Current</u>	<u>Required</u>	<u>Increase %</u>
Zone A - Standard Lighting	\$17.03	\$38.79	128%
Zone B - Gas Light Area	\$87.08	\$155.17	78%
Zone C - The Strand	\$10.52	\$116.37	1006%
Zone D - Walkway Streets	\$10.80	\$38.79	259%
Zone E - Arbolado Tract	\$126.34	\$155.17	23%

These figures are based on first year costs of \$657,326 as outlined in the report.

While technically classified as a Special Revenue Fund, Street Lighting and Landscaping Districts are quasi enterprises; they are designed to function in the same manner as enterprises, meaning charges (assessments) for service should be sufficient for the operations to be self-supporting.

### *Survey Results*

Through Harris and Associates, a survey was conducted by the firm of True North Research based on the above fees and assessments (please see Attachment #4). By way of a summary, staff recommends a review of pages 5 through 10 of the report, which includes the main factual findings and conclusions.

As described in more detail in the report, neither measure (Storm Water or Street Lighting and Landscaping) garnered the majority required for passage in the survey. Property owner support for the Lighting and Landscaping measure, in particular, was quite low. Even when the rate was reduced to 60% of the proposed fee, support never eclipsed 38% once the weighted votes were factored in.

Support was stronger for the Storm Water fee (reaching 44% at 60% of the proposed fee), but it's clear that for a measure to have a reasonable chance of success a more modest fee (e.g., \$35 to \$49 per year for the typical property) will be required, along with a number of other conditions spelled out in the report (clear support from the City Council, effective public education, a well-organized independent campaign, etc.).

Dr. Timothy McLarney from True North Research will present the survey results and will be available to answer questions at the Study Session.

### ***Risks from Continued Subsidies***

While already stated, the importance of correcting the funding imbalance, particularly in Storm Water, cannot be overemphasized. Recognized experts and organizations in public finance recommend

several practices with regard to enterprise funds. For example, the Government Finance Officers Association (GFOA) states that “it is essential that a government maintain adequate levels of working capital in its enterprise funds to mitigate current and future risks and to ensure stable services and fees.”

Additionally, Michael Coleman, recognized in the state of California as an expert on local government finance, says that “unless there is a specific reason otherwise, enterprise funds should be self-supporting; cities get into trouble when they continue to subsidize a worsening condition, unless there is a strong public benefit and the subsidy is maintained at a static level” (the latter of which is clearly not the case for Storm Water and Street Lighting).

In 2011, Moody’s Investors Service downgraded the City of Fresno, California from Aa2 to A2 (four ratings lower) in part because of increasing General Fund subsidies for underperforming enterprises, and indicated that the rating could improve if there were to be increased self-sufficiency and decreased subsidies for those troubled enterprises.

More recently, in 2012, Moody’s downgraded the City of Burlington, Vermont from A3 to Baa3 (four ratings lower) due to strains on the City’s resources caused by non-self-supporting enterprise funds, and cited the situation as being caused by inadequate rate increases in prior years.

While the City of Manhattan Beach may not be in the same situation as Fresno or Burlington, it is clear that the rating agencies view on-going enterprise fund subsidies negatively. As a Triple-A rated city, Manhattan Beach would be expected to proactively correct these subsidies.

As a reminder, the City’s Financial Policies state that Enterprise Funds will maintain reserves equal to four months of operating expenses. For Fiscal Year 2014-2015 that reserve for Storm Water should be approximately \$250,000. However, because we are projecting that by June 30, 2015 there will be no fund balance in Storm Water, there are no funds available for that policy reserve. Street Lighting should also have a reserve of \$217,000 but there is no available fund balance. Unfortunately, the General Fund is now the de facto backstop for these enterprises.

Finally, it is important to note that the Storm Water and Street Lighting funds are not only directly subsidized through cash transfers; the support provided to those enterprises by General Fund resources, which should be reimbursed, is not being collected due to the lack of funds. The total loss to the General Fund from non-reimbursement is approximately \$200,000 per year.

The most salient question when considering the risks of continued subsidies is this: What could the City do with \$7 million over the next five years if it wasn’t needed to support programs that by design should be self-sustaining?

### **Next Steps**

Given the information provided by the preliminary studies and survey, the City Council needs to determine if the City should proceed with a Proposition 218 process for Storm Water fees and/or Street Lighting and Landscaping District assessments. This would include further assistance from the engineering firm, public education and outreach, and polling among other steps. The estimated cost is \$125,000 to \$175,000 for each process (Storm Water and Street Lighting), which may be recovered through the fees and assessments. The timeline for such processes is 12-18 months.

If the City Council wishes to proceed, staff will return with the necessary contracts and specific details of the processes.

### ***Other Potential Revenues***

At the request of City Council, staff has included information on potential General Fund revenues, including the Transient Occupancy Tax (TOT), a Utility User Tax (UUT) and a Sales Transaction Tax (STT). While these are presented as part of the report on funding for the Storm Water, and Street Lighting and Landscaping Districts, it is important to note that TOT, UUT and STT are General Fund revenues that can be used for many purposes (capital improvements, additional services, etc.) and should not be used as a long term solution to the funding of Storm Water and Street Lighting, which have dedicated sources for which corrective action is needed.

#### ***Transient Occupancy Tax (TOT)***

The City currently collects a 10% TOT on all hotel and motel room rentals, as well as vacation rentals, of 30 days or less. Fifteen percent of the hotel and motel TOT is directed to the City's Capital Improvement Project (CIP) fund for debt service on the Police/Fire facility and to fund general non-enterprise or Special Revenue fund improvements. The balance is deposited in the General Fund (the vacation rental TOT revenue is purely General Fund). The TOT for FY 2014-2015 is projected to generate \$3,769,000. As a result, each 1% increase in the TOT rate would be expected to generate \$376,900.

Attachment #5 includes a survey of TOT and UUT rates of surrounding cities. Other agencies' TOT rates range from 8% in El Segundo to 14% in Santa Monica, Beverly Hills, Inglewood and Los Angeles (these rates exclude any tourism or hotel improvement district fees).

Changes to the TOT require a vote by the electorate. If the funds will be used for general purposes then a simple majority is required for passage. If the funds are to be dedicated to a particular purpose, then a super majority (2/3rds) approval is required.

#### ***Utility User Tax (UUT)***

While the City of Manhattan Beach does not currently have this tax, it is common for cities to impose (with voter approval) a tax on the use of utilities. These typically include cable television, telephone service, natural gas, electricity, water, sewer, etc.

Attachment #5 includes the UUT rates for other communities, which range from 0% to 10% depending upon the utility being taxed. The cities of Beverly Hills, Palos Verdes Estates and Rolling Hills along with Manhattan Beach do not impose or collect the tax. The other cities listed range from 2% to 10%.

A preliminary analysis of a UUT in Manhattan Beach indicates potential annual revenue of approximately \$880,000 from each 1% if charged on the aforementioned services (with the exception of telephone services for which we have no current data on revenues generated by the carriers). Imposing a UUT requires a vote by the electorate. If the funds will be used for general purposes then a simple majority is required for passage. If the funds are to be dedicated to a particular purpose, then a super majority (2/3rds) approval is required.

### *Add-On Sales Transaction Tax (STT)*

An increasingly popular method for cities to generate revenue is through an increase in the local sales tax (a transaction tax). Cities have used this tool to fund general needs as well as specific purposes including police/fire services, flood control, streets and road, etc.

Like the TOT and UUT, imposing a STT requires a vote by the electorate. If the funds will be used for general purposes than a simple majority is required for passage. If the funds are to be dedicated to a particular purpose, then a super majority (2/3rds) approval is required. Recent statistics show that 68% of city general purpose sales transaction tax ballot measures have been successful. Specific purpose city sales transaction tax measures have been less successful at 50% approval.

By way of mechanics, the sales transaction tax would be added to the existing sales tax rate in Manhattan Beach (9%), and collected on all retail transactions. Staff estimates each one-quarter percent (.25%) of sales transaction tax would generate approximately \$2,225,000 annually. The maximum transaction tax allowable by law is 2%.

### **CONCLUSION:**

The City currently subsidizes Storm Water and Street Lighting and Landscaping District activities. Over the next five years, those subsidies are expected to total approximately \$7 million, which reduces funds available for General Fund purposes including police, fire and paramedics, as well as general non-enterprise capital improvement projects.

The studies performed by Harris and Associates indicate that sizeable increases are needed in both Storm Water fees and Street Lighting and Landscaping District assessments in order to fully fund these enterprises. However, the survey conducted on these topics concluded that there is not sufficient support for full cost recovery fees and assessments, but that the Storm Water fee may have a reasonable chance of success if a more modest fee were pursued. It also listed other conditions that need to be present for success, including clear support from the City Council, effective public education, a well-organized independent campaign, etc.

Staff has also presented several potential General Fund revenue sources which may be used to fund enhanced services. While these are presented as part of the report on funding for the Storm Water, and Street Lighting and Landscaping Districts, it is important to note that TOT, UUT and STT are General Fund revenues that can be used for many purposes (capital improvements, additional services, etc.) and should not be used as a long term solution to the funding of Storm Water and Street Lighting, which have dedicated sources for which corrective action is needed.

### Attachments:

1. City Council Staff report from 8/21/2013 on Funding Options for Storm Water and Street Lighting
2. Storm Water Utility Fee Preliminary Study
3. Street Lighting and Landscaping District Assessment Preliminary Study

4. Revenue Measure Survey results
5. Utility User Tax and Transient Occupancy Tax Comparison Chart