



CITY OF POMONA COUNCIL REPORT

July 16, 2018

To: Honorable Mayor and Members of the City Council

From: Linda Lowry, City Manager

Submitted by: Onyx Jones, Finance Director/City Treasurer

Subject: **Consideration of the Strategy to Preserve Vital City Services and Directing Staff to Present Necessary Documents to Place Potential Revenue Measures on the November 2018 Ballot**

OVERVIEW

Recommendation – That the City Council:

1. In keeping with the Proposed Fiscal Strategy Outlined in the Ten Year Fiscal Sustainability Report presented by Urban Futures Inc. (UFI) and with the aim to preserve vital City services, Staff recommends that City Council direct staff to present necessary documents to place potential revenue measures on the November 2018 Ballot; and
2. Give direction to staff regarding decision points of a potential Transaction and Use Tax (TUT) measure, which is also known as a Sales and Use Tax Measure; and
3. Give direction to Staff regarding decisions points of a potential Cannabis Tax Measure.

Fiscal Impact – There is no financial impact with this staff report; however, if Council gives direction to place a revenue measure on the November 2018 Ballot there will be election cost, that are currently budgeted in the FY 2019 Budget. If actual election cost are higher than the FY 2019 budget, a budget adjustment will be brought back to Council during the Mid-Year process. The proposed TUT measure could generate an additional \$12M in General Fund revenues. The proposed Cannabis Business Tax Measure could generate anywhere from \$500K - \$2M in Business Tax revenue based on the number of permits issued.

Previous Related Action – On May 14th 2018, during the City's annual Budget Study Session, Staff was able to present the final Phase II of the 10 Year Fiscal Sustainability Analysis which included a very detailed written report from UFI that clearly defined the current financial situation of the City of Pomona, and made recommendations of various

strategies to be taken immediately to preserve vital City services. On page eight of UFI's report they indicated that if no action is taken by the City, the City of Pomona would be cash insolvent, service insolvent and budget insolvent by FY 2021.

On May 7th 2018, UFI presented Council with a power point presentation that updated the Ten-Year Fiscal Sustainability Plan based on FY 2019 Budget projections. UFI also included specific recommendations for Council to consider that could generate additional revenues for the General Fund and methods to streamline and reduce cost.

On December 11, 2017 City Council reviewed and discussed Phase I of the Ten-Year Fiscal Sustainability Plan presented by UFI.

When the City Council adopted FY 2017-18 Operating Budget there was significant discussion of the critical need for the City to develop a long-term financial plan. To that end, the City Council approved a professional services agreement with Urban Futures, Inc. on August 7, 2017 to draft a financial plan.

EXECUTIVE SUMMARY

The City of Pomona currently has a budget deficit of \$4.7M. Additionally, when you eliminate the use of one-time monies, the City's General Fund could experience budget insolvency and an annual operating deficit of \$8M to \$10M over the next ten years. At this rate, the General Fund would deplete its \$16M in reserves by FY 2020/2021. On May 7th 2018, UFI presented Council with a Ten Year Fiscal Sustainability Plan that included numerous solutions for balancing the budget. After careful consideration of each of the options presented, staff is respectfully recommending that City Council ask voters to consider enacting a general purpose $\frac{3}{4}$ cent local transaction and use tax (Sales Tax) and a Cannabis Business Tax to be used to continue to support City services such as police, fire, libraries, parks and recreations and other programs.

DISCUSSION

In 2008, when the City of Pomona's General Fund revenues were at its highest levels, there was also an operating deficit of \$3M. Immediately, following that year, the economic recession hit and General Fund revenues declined at an alarming rate from FY 2008 to FY 2012. The City had to make significant cuts to the budget from FY 2010 to FY 2013.

- Community Programs were cut
- The total number of authorized positions decreased from 777 in FY 2008 to as low as 539 in FY 2013 (31 of those positions eliminated were sworn police positions)
- City employees who remained agreed to furloughs, salary cuts, paying for a portion of retirement contributions and non-competitive medical benefits
- Maintenance on City buildings and parks was deferred
- Software and hardware in the IT Department had minimal upgrades
- Street related services that were previously funded by the General Fund had to be funded with Special Revenue Funds such as Gas Tax
- Some services such as parks and landscape maintenance were contracted out

In preparing the City's ten year forecast and analysis, UFI worked with City staff in the Finance Department, Human Resources Department, and other departments. UFI relied on the City's historical data, published documents from the City, CalPERS, the City's actuary for other post-employment benefits (OEPB), and the City's labor costing to develop projections. This data was used to construct a long-range budget model tailored to the City's specific financial situation. Staff reviewed the model presented by UFI in detail and based on the options presented the proposed ballot measures will not only preserve the City's current service levels, but generate approximately \$12M-\$14M in General Fund revenues.

Transaction and Use Tax (Sales Tax) Measure

State law provides that individual jurisdictions (cities) may form one or more transaction tax districts as long as the total tax levy, including the rate of countywide districts, does not exceed 2.0 percent. Agencies in Los Angeles County that do not currently have a transaction tax, have the ability to approve a tax measure up to .75 percent without the need for special legislation. If the tax measure is approved during the November 2018 election it would be effective April 1, 2019 and the City would receive the first advance from the BOE in June 2019. The first full year of revenue would be FY2020.

A sales tax measure would be paid by all those shopping in Pomona, not just residents. Each day many people commute to Pomona to work, attend school/college, or to enjoy the City's amenities such as the Downtown area or events held at the Fairplex. These visitors would be paying their fair share for using our roads, 911 or other services. Thus, a sales tax measure would be spread across a large base of consumers, while the $\frac{3}{4}$ cent local tax would be expected to generate approximately \$12M per year, to the consumer it would add only 75 cents to every \$100 of taxable transactions. Note: the proposed sales tax measure would not be applied to food purchased such as groceries or prescription medication.

Table 1 outlines potential revenue amounts obtained during the initial year of implementation based on a .75% tax rate. Revenues could increase further since businesses often reach full compliance with a new rate during the second year of implementation.

Transaction Tax Category	Estimated 0.75% Transaction Tax \$
Autos and Transportation	2,355,000
Building and Construction	1,164,000
Business and Industry	2,012,000
Food and Drugs	757,000
Fuel and Service Stations	1,435,000
General Consumer Goods	3,033,000
Restaurants and Hotels	1,669,000
2% Deduction for first year start up	(249,000)
Admin Fees	(106,000)
TOTAL EST. (.75%) SALES TAX	12,070,000

Table 1

Decision points: Council Direction Required

If so directed by Council, Staff and the City Attorney will prepare appropriate documents and return to the City Council at the August 6, 2018 Council meeting, in order to call the election for the November 2018 ballot. There are some specifics that Staff would like to get Council direction on prior to developing the ballot measure language. Those items include:

1. Determine General Tax versus a Special Tax.

- a. A General Tax is for general purposes that can be used to provide all services in the General Fund and it requires approval by four fifths vote of the City Council followed by a simple majority (50 percent +1 vote) approval of the voters.
 - b. A Special Tax contains limits towards spending on a specific government project or program (i.e. Police or Fire Services). A special tax requires a simple majority vote of the City Council followed by a two-thirds approval of the voters. The spending purposes are articulated in the ballot language and fixed for the duration of the tax until and unless changed by the voters through the same process.
2. **Recommended:** Adding language in the Ordinance that allows Council to lower the tax rate during budget cycles where the budget can be balanced without the use of the full amount of the sales tax measure.
 3. **Recommended:** Adding language in the Ordinance that allows for the creation of an Oversight Committee that is formed to make recommendations to City and provides oversight on how the funds from the tax measure will be used.
 4. **Consider:** Adding language in the Ordinance that implements a 10 year sunset period. At the end of 10 years, City Council would have to go back to the voters if the City still has a financial need to continue the tax measure. This clause is sometimes used to encourage voters to vote in support of the measure. However, in the most recent June 2018 election five sales tax measures for Cities were passed and none of them included a sunset clause.

Cannabis Business Tax Measure

The City has the legal authority to impose a business or excise tax upon the gross receipts of Cannabis sales, services and transactions, provided the tax is approved by the voters as required by the California Constitution (Proposition 218, enacted by voters in November 1996). In order to place a tax measure on the November 6, 2018 ballot, it takes a 2/3 vote of the City Council (at least 4 members). The voters must approve the establishment and rates of a commercial cannabis tax. If passed by the voters, the tax would be effective April 1, 2019.

As with most policy actions, enacting a cannabis tax has advantages and disadvantages. Some arguments in favor include:

1. The tax measure would generate additional City revenue from which all residents can benefit;

2. Businesses that are operating illegally would owe taxes, as well as those that may one day operate in the City legally;
3. Tax rates can be set to influence industry; high rates might discourage industry participation and low rates might encourage it;
4. Because the tax is established by the local electorate, it cannot be taken away by the State.

Some arguments against include:

5. Tax increases are not always perceived positively by the citizens;
6. Taxes in an amount that the industry perceives as burdensome may drive businesses underground, rather than encourage them to operate legally in the City.

Decision points: Council Direction Required

The city hired HdL Companies as consultants to prepare information for Council on the tax measure and to prepare the resolution, ordinance, and ballot language for cannabis business tax, if approved by Council. HdL Companies has extensive experience in preparation of commercial cannabis tax measures and have provided some recommendations on the decision points.

A. Amount of Proposed Tax

The commercial cannabis businesses that may be taxed include commercial cultivation, testing labs, retail sales (including both store front and non-store front), distribution, and manufacturing. Rates can be set flat or can be scaled to increase over time. Council can reduce the tax rate at any time by resolution or ordinance. Commercial cannabis tax rates vary across cities. These rates can often influence industry activity in the city.

The following are suggested rates for discussions:

Commercial Cultivation

1. Based on square footage:
 - a. Seven dollars (\$7.00 initially and max. \$10.00) annually per square foot of canopy space in a facility that uses exclusively artificial lighting.
 - b. Four dollars (\$4.00 initially and max. \$7.00) annually per square foot of canopy space in a facility that uses a combination of natural and supplemental artificial lighting
 - c. Two dollars (\$2.00 initially and max. \$4.00) annually per square foot of canopy space in a facility that uses no artificial lighting.
 - d. One dollar (\$1.00 initially and max. \$2.00) annually per square foot of canopy space for any nursery.
2. Based on gross receipts
 - a. For every person who engages in commercial cannabis cultivation other than as a

nursery shall be subject to two and half percent (2.5% initially max. 4%) of gross receipts.

- b. For every person who engages in commercial cannabis cultivation as a nursery shall be subject to two and half percent (2.5% initially max. 4%) of gross receipts.

Laboratory

- a. For every person who engages in the operation of a testing laboratory: one percent (1% initially and max. 2.5%) of gross receipts.

Retail Sales

- a. For every person who engages in the retail sales of cannabis as a retailer (dispensary) or non-store front retailer (delivery) or microbusiness (retail sales): Four percent (4% initially and max. 6%) of gross receipts.

Distribution

- a. For every person who engages in a cannabis distribution business: two percent (2% initially and max. 3%) of gross receipts.

Manufacturing

- a. For every person who engages in a cannabis manufacturing, processing, or microbusiness (non-retail), or any other type of cannabis business not described in Section (B) (1), (2), (3) or (4): Two and half percent (2.5% initially and max. 4%) of gross receipts.

B. Determine General Tax vs. Special Tax

1. A General tax is for general purposes that can be used to provide all services in the General Fund and it requires approval by four fifths vote of the City Council followed by a simple majority (50 percent +1 vote) approval of the voters.
2. A special tax contains limits towards spending on a specific government project or program (i.e. Police or Fire Services). A special tax requires a simple majority vote of the City Council followed by a two-thirds approval of the voters. The spending purposes are articulated in the ballot language and fixed for the duration of the tax until and unless changed by the voters through the same process.

According to industry representatives, cumulative taxes exceeding 30% across all businesses would become a barrier to businesses that wish to operate legally or otherwise drive cannabis businesses to other communities with more favorable tax policies. Under the AUMA, all cannabis businesses, whether they are medical or non-medical, are subject to a 15% state excise tax. In addition, cultivators are subject to a state tax of \$9.25 per ounce of flower or \$2.75 per ounce of leaf. The per-ounce tax on cultivation is equivalent to a 10-15% tax on gross receipts. For non-medical retail businesses, the consumer will also be subject to state and local sales taxes required to be collected by the retail business.

The state is issuing separate licenses for medical cannabis businesses and non-medical (adult use) marijuana businesses, although a business can have both. The medical cannabis businesses

presumably will be developing different and more unique products needed for medicinal purposes. However, from a taxing perspective, the state's taxes apply equally to both. The only distinction from a taxing perspective is consumers that have a medical card issued by the state will be able to avoid paying state and local sales taxes. As such, medical marijuana consumers will get some relief in price relative to recreational consumers.

Other Considerations

The sale of cannabis is not legal under federal law. Banks have generally not allowed cannabis businesses to establish bank accounts based on current federal law. Consequently, cities that have imposed a tax on cannabis have had to establish protocols and security procedures for the delivery of cash to their cashiers' office. A cash counting machine is used in most cases to facilitate and expedite the counting of the cash. Some cities have required appointments monthly for dispensaries to bring in the tax monies. In addition, assistance from the police department has been required in some cases to provide added security during the counts. Overall, the cash handling requirements have not created undue challenges or roadblocks to the imposition or collection of the taxes, but they have resulted in additional city costs.

Conclusion

Council direction is critical at this time for a number of reasons. Currently, the City's FY 2019 Budget has a \$4.7M deficit and reserves are projected to decrease to \$12M, which is well below the City reserve policy. In the event the proposed tax measures are not successful staff will be forced to consider alternate options from UFI's report, which included reducing or eliminating neighborhood services, parks, community facilities, fire stations (requires renegotiations with County Fire), gang suppression units, major crime units, library services, code enforcement, and internal service funds such IT or vehicle maintenance.

If Council gives direction for Staff to continue with the ballot measures, the final ballot language would need to be approved during the August 6th 2018 Council meeting. Once the documents have been properly submitted to the County, the City must prepare for a November 2018 ballot with robust public outreach, polling, and informational campaigns. It will require the support of Council Members, City Staff, employee organizations, and community groups.

Attachments:

1. HdL Report for City of Pomona Estimates and Analysis of a Transaction and Use Tax
2. Results for June 2018 tax measures