City of San Diego
Facilities Financing Study

Prepared for
the Strategic Framework
Citizen Committee
Finance Subcommittee

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PART I – BACKGROUND

Introduction

The City's Facilities Financing Program currently identifies about $2.5 billion in public facilities required to meet current General Plan standards in the City's twenty-six "Urbanized Communities." The focus of this report is on the alternatives available for financing infrastructure in those existing urbanized areas, so as to bring them up to current standards prior to their absorbing additional population growth. Private and public funding mechanisms are generally sufficient to provide for capital facilities in the newer "Planned Urbanizing" communities. As identified in the existing Community Facility Financing Plans, the primary unmet needs in the urbanized communities are in the categories of park and recreation facilities; local street, traffic flow and pedestrian improvements; libraries; and fire stations.

This report addresses a variety of funding sources utilized by California municipal entities, as well as comparisons with several out-of-state peer group cities. Evaluation of funding options and selection of appropriate revenue mechanisms must be carried out in the context of various constraints, including:

- California law: the State Constitution imposes various restrictions on municipal revenue-raising powers, perhaps the most important of which is that most revenues require majority or two-third approval by voters;
- Policy considerations: the delivery of public services must always reconcile questions of who pays and who benefits. Such questions come to the fore here, as the City seeks to finance primarily local street and park improvements in support of increasing density to meet regional objectives;
- Competing priorities: the need for additional urban public facilities represents only a portion of the City's infrastructure and service priorities that must be financed from limited municipal resources. In addition, it is anticipated that the City's elected decision-makers may at some point include discussion of operating and maintenance requirements in conjunction with this report's focus on capital needs.

The goal of this study is to describe the menu of options available to City decision-makers for developing a balanced plan of finance. Table 1 outlines the major revenue options available to the City. Because the City has a relatively low overall tax burden, which results partly from the fact that the City does not levy taxes or fees common to many California cities such as utility users taxes or refuse collection fees, there are a number of viable alternatives. We recommend that the City consider commissioning a public opinion survey to help San Diego in shaping the most viable plan of finance.

Given the magnitude of the financing needs, it is likely that more than one of these tools will need to be pursued. It is also likely that while some financing techniques will be employed to finance improvements in all the urbanized communities, other techniques will be adapted to the specific needs of specific communities.

The role of collaborative, coordinated efforts that go beyond the strict limits of city government in providing for both public facilities and their operation is key to adequately addressing the needs. In addition to the City's contribution to urban infrastructure, the Metropolitan Transit District, the school districts, the County of San Diego, federal housing funds, and State and federal transportation funds, among others, all need to play a contributing role in order to achieve urban facilities goals.

The development of "Pilot Villages" will involve a prioritization of the specific needs of each community as well as a review of funding opportunities among all relevant public and private entities. It is expected that this approach of fostering demonstration projects in the form of "Pilot Villages," which incorporate resources from the City and also draw upon the resources of other entities, will provide a model capable of achieving widespread results.

Table 1

City of San Diego
Major Revenue Options

Tax/Fee	Voter Requirement[1]	Basis of Levy	Revenue Generation	Assumptions
Ad Valorem Property Tax - Override for Bonds	2/3 rds	City-wide, based on assessed value of property. An increase of the tax rate above 1% is limited to servicing bond debt service.	$44 million a year generated by tax rate of 0.05% (would support a bond issue of $600 million).	Based on assessed valuation of $88 billion. Bond proceeds assume 5 cent tax rate per $100 assessed valuation, and 30 year bonds at 6%. Equivalent of $101.32 for average ($202,631) assessed-value home.
Sales & Use Tax [2] (Local Sales Tax)	50% if levied for general purposes[3]	City-wide, as a % of taxable retail and business-to-business sales.	$42 million a year per 0.25%.	Based on City receipts of $168 million from 1% local sales tax.
Transient Occupancy Tax	50% if levied for general purposes[3]	City-wide. Primarily derived from visitors.	$23 million a year for a 2.5% increase.	Based on $96.8 million at 10.5%.
Business License Tax	50%	City-wide, although specific rates could reflect policy priorities.	Additional $4.7 million from doubling of current rates of general business licences. Alternatively, an increase from $5 to $100 per employee at large firms would generate additional $23.7 million a year.	Doubling based on equivalent to current revenues. Increase of taxes on employers of 13 or more assumes 250,000 employees at such companies.
Utility Users Tax	50%	City-wide.	$45 million a year for a 2.5% tax rate.	Assumes each 1% in tax generates equivalent of about $15 per capita.
Franchise Taxes/Fees	Set by negotiation with individual utilities	While directly levied on utilities, effect would be City-wide	As negotiated.	Current franchise fee on electrical, gas and cable televison utilities (usually at 3%) currently generates about $38.6 million.
Transfers from Municipal Utilities (e.g., right-of-way fees)	None, although may be vulnerable to Prop. 218 challenge	Effect would be City-wide.	$15.8 million per 5% "right-of-way fee" on water and sewer enterprises.	Based on 1997 budgeted amounts.
Real Property Transfer Tax	50%	Levied on property sales.	$21 million a year at a tax rate of $2.75 per $1,000.	Based on FY 2000 receipts of $5.3 million at $0.55 conforming rate, netting out sacrificed conforming receipts.
Parcel Taxes (including Mello-Roos)	2/3 rds (vote can be by property owners, if less than 12 registered voters)	Can be levied City-wide or locally.	Varies, based on specific tax.	
Storm Drains Fees	Unresolved under Prop. 218; probably requires 50%	Most likely City-Wide.	Additional $6 million a year from doubling of fee from $.95 to $1.80.	Based on current receipts.
Refuse Collection Fees	50% to amend the City Municipal Code	City-wide, on residential collection.	Approximately $32.7 million a year annually based on an average monthly fee of $8.95.	General Fund appropriation in FY 2002 Budget ($32.7 million) divided by 305,000 residences and small businesses.
Benefit Assessments (e.g., Street Lighting or Maintenance Assessment)	50% of property owners	Levied on property within a benefit assessment district. Based on a calculation of the special benefit.	To be determined.	Currently, $15.8 million in General Funds and $19.2 million in Gas Tax Funds are appropriated to street maintenance. A significant portion of this might be financed with the creation of one or more assessment districts.
Collaborative Funding/Provision of Facilities	N/A	N/A	To be determined.	Coordinated Joint Use through co-location of facilities with schools; MTDB demonstration projects supporting "Pilot Villages;" Federal, State, and County funding opportunities/coordination.

[1] Based on State law. A recent City proposition would require 2/3rds voter approval on all *tax* increases, although its implementation is the subject of current litigation. See Section 3E discussing local legal constraints on revenues.
[2] There is a statutory provision for County-wide local sales tax. A City-wide tax would require special legislation, which has occurred from time to time.
[3] Sometimes levied as a special tax, requiring 2/3 rds voter approval.

1. PROJECT MISSION STATEMENT: Strategic Framework Element

A. Goal of the Committee & Financial Advisor's Report

As stated in the City Manager's Report (Report No. 01-140) dated July 11, 2001:

> "The Strategic Framework Element is a proposed new chapter of the City's *Progress Guide and General Plan* (General Plan) that sets forth a strategy for growth and development of the City. The element proposes a City of Villages strategy to focus growth in compact, mixed-use centers linked by transit. It has been forecast that the City of San Diego will require approximately 17,000 to 37,000 additional dwelling units over our adopted community plan capacity to meet the needs of our population over the next twenty years. The proposed Strategic Framework Element does not encourage or discourage growth, but would accommodate the City's forecasted population growth when and if it occurs. As forecasted population growth is realized, over the next 10, 20 or 50 years, the proposed village design concept would enable growth to be located in such a way that the quality of life for City residents is maintained or improved."

The goal of the Financial Advisor has been to augment the work of the Finance Citizen Subcommittee (the "Committee") of the Strategic Framework Citizen Committee, in developing infrastructure financing options with respect to the Strategic Framework Element. City staff has indicated that financing vehicles necessary to fund the infrastructure needs created by new development are outside the scope of this report. Rather, this report focuses on financing infrastructure in the existing urbanized communities required to meet the standards in the currently existing General Plan. Our mutual task involves the following scope of work:

- Reviewing the funding sources currently used to finance capital improvements and facilities and the degree to which they have been fully utilized.
- Examining the City's tax burden and comparing this tax burden with that of other major California and western cities.
- Performing a comparative study of financing techniques used in other major California and western cities to provide capital improvements and facilities.
- Identifying options for changes in the utilization of current funding sources.
- Identifying new funding sources, financing mechanisms, and additional revenues that might be available.
- Discussing the limitations of any new funding sources.
- Discussing the policy and legislative implications of recommended financing alternatives.

- Providing assistance in taking into account other competing City priorities in evaluating and recommending financing alternatives.

The Committee and City Staff will use the work of the Financial Advisor to help draft an overall financing strategy for infrastructure improvements within the urbanized communities for consideration by the City Council and the public.

B. Summary of Capital Finance Requirements

Within the City's urbanized communities, the following capital needs were preliminarily identified by City staff at the start of this project:

Table 2

City of San Diego
Capital Finance Requirements

Facility	Estimated Needs
Fire[1]	$ 61,720,416
Library[1]	142,708,002
Parks and Recreation	884,974,939
Flood Control	122,700,614
Transportation and Streets	1,778,891,026
Subtotal	2,990,994,997
Adjustment factor[2]	368,365,100
Available Funding[3]	(859,360,097)
Required Funding	**$2,500,000,000**

[1]Funding for all or some of these projects may be provided as part of City-wide financing programs now under development.

[2]Accounts for anticipated inflation as individual community facility plans are updated; many existing plans are up to ten years old.

[3]Funding that has already been identified and allocated to projects, such as fees paid by developers, State grants, and Community Development Block Grant funds.

Source: Planning Department, City of San Diego

The needs identified above represent the existing deficiencies of the 24 urbanized communities in meeting current General Plan standards. The needs are based on the existing Community Facility Financing Plans for the urbanized communities. Planning Department staff believe that, in order to amend the General Plan to increase densities in these communities under the "City of Villages" concept, current deficiencies in infrastructure must be addressed, bringing the public facilities in these communities up to current standards.

Note that the above estimates do not include improvements to the water and sewer utilities, for which funding plans are separately identified under the City's respective water and sewer capital improvement programs, or for transit improvements that might be financed through TransNet and other dedicated transportation funds. Public transit, provided by the Metropolitan Transit District, is also not included in this capital needs list. The estimates of capital needs identified above also exclude the additional infrastructure that would be required to serve additional population densities envisioned under the City of Villages model as well as in other areas of the City; these capital costs represent only the current deficiencies.

2. SCOPE & METHODOLOGY

A. Identification of In-State and Out-of-State Peer Group Cities

One objective of this report is to compare San Diego to similar cities within California with respect to revenue-generating and financing activities, including debt issuance. The goal of this comparison is to help identify practical options for financing the capital deficiencies in the urbanized communities. After meeting with City Staff and the Financial Advisor, the Committee decided to include 13 California cities, in addition to San Diego, as the main focus of our comparative research. These cities represent San Diego's peers in terms of size and/or economic profile (such as being a center for business or tourism).

The Committee also selected several out-of-State cities to review, because of these cities' reported strong levels of economic growth, financial stability and favorable business and commercial climates. The Committee recognized that, because of different State laws regulating taxation and revenues, strict comparisons with San Diego among the out-of-State cities would not be possible. In addition, the tax and revenue structure of the local jurisdiction is only one element that influences a local economy, and other factors such as work-force availability and housing affordability are not addressed in this report.

The selected California peer group cities include (1) the City and County of San Francisco; (2) the other top ten California cities ranked by population; (3) and the cities of Santa Barbara and Santa Clara, because the latter are viewed as competing with San Diego for tourism and new business location, respectively. The Committee recognized that San Francisco's inclusion might skew the data, since San Francisco receives both city and county revenues. However, the Committee concluded that, because of its similarity to San Diego in both size and economic profile, information on San Francisco would prove useful. In the final analysis, the Committee selected the following cities as San Diego's in-State and out-of-State peers:

California Cities

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

Out-of-State Cities

- Austin
- Denver
- Phoenix
- Portland
- Seattle

This report compares the peer group cities to San Diego with respect to: (1) the types of revenues generated, (2) the relative mix of these revenues per capita or as a percent of total revenues, and (3) the types of debt financing vehicles that these cities employ to leverage these revenues. The goal of this comparison is to present the City with a menu of options for raising revenues to finance capital improvements, both through direct appropriation ("pay-as-you-go") and through debt serviced from the new revenues. It will be up to the City's policy-makers and the public to review these and other options with respect to their long-term viability.

B. Sources of Data

The data sources for this report include June 30, 2000 Comprehensive Annual Financial Reports (or "CAFRs") and FY 2000-2001 budgets of the peer group cities, as well as information gathered through telephone interviews with city officials. Unless otherwise indicated, the data is for the 1999-2000 fiscal year. The interviews have been necessary because of the limited way in which data are often presented in CAFRs and budgets. For example, a city may report fees for business licenses as a line item in the General Fund, but not the rate at which the revenue is calculated. Tax rates are often as important as the absolute amount of taxes collected, particularly for items such as the utility users tax, business license tax and transient occupancy tax.

C. General Overview of Governmental Fund Accounting & California Municipal Revenues

Municipal entities follow certain standardized accounting practices set by the Governmental Accounting Standards Board, wherein revenues are accounted for within broad categories of fund groups. The basic fund groups that are relevant to the study of municipal finance are the following:

- The *General Fund* is unrestricted, and accounts for all revenues that are not, due to their particular restrictions, placed in other funds. The General Fund receives most of a city's tax revenues, including property and sales taxes; charges for current services; fees for non-utility services; fines; and income from interest, rent and the sale of property. The General Fund is a key focus of the analysis in this report, as it accounts for those municipal revenues that can be used for any public improvement or service.

- *Special revenue funds* account for revenues that are earmarked for a specific purpose. An example is a city's share of the gas tax collected by the State for street improvements. Most often, the treatment as a special revenue reflects legal restrictions on the use of the revenues, although some special revenue funds may simply reflect a policy decision to establish a separate accounting mechanism to earmark monies intended for a specific use.

- *Enterprise funds* account for a local government's enterprise activities, similar to those found in the private sector, where a measurement of net income is necessary or useful. Most enterprise funds account for true municipal enterprises, where service charges and other utility-type revenues are the primary source of income. Types of municipal activities accounted for by enterprise funds may include sewer, water, electric utilities, golf courses, parking facilities, and marinas.

- Other standardized funds include *debt service funds*, which account for monies accumulated to repay indebtedness, and *capital project funds*, which are used to account for receipts and disbursements related to specific capital or building programs.

There are often minor variations in the way cities account for revenues and expenditures, which makes precise comparison difficult. For example, while most cities deposit all sales tax revenues into their General Fund, San Diego accounts for some of its sales tax receipts in its Police Decentralization and Transient Occupancy Tax special revenue funds. Where possible, the data has been adjusted for such variations.

Funds are simply categories used to account for revenues. The revenues themselves are subject to State and local law regulating local government's ability to tax, levy fees, and spend. In particular, the California Constitution imposes a number of restrictions on certain revenues and how they may be increased. The following is a discussion of municipal revenues as generally categorized under California law, focusing on the requirements of voter or similar approvals; the next section of the report elaborates on specific State propositions that regulate local governments' taxing and spending powers and revenue-generating capabilities.

- *General taxes* are taxes that do not bear a direct relation to any municipal service, and therefore do not have to reflect the cost of providing that service. Typically, general taxes represent the largest type of General Fund revenue. Due to Proposition 218, approved in 1996, levying new or increasing existing general taxes now require simple-majority voter approval,

- *Special taxes* are taxes that are levied for a specific purpose and require a 2/3^{rds} voter approval under Proposition 13, approved in 1978.

- *Special assessments* are charges to specific property owners to recapture the "special benefit" that the property receives from a government service or a capital improvement. Proposition 218 tightened the definition of a "special benefit" and introduced a simple-majority property-owner vote to institute or increase special assessments.

- *Fees and charges for current services* are charges a municipal government can levy to reimburse itself for the cost of providing certain services (such as water, sewer or refuse) or the cost of a regulatory function (such as issuing building permits). Proposition 218 (1996) created a new definition of fees "for property-related" services, and imposed new approval requirements. The definition of a "property-related" service is still being interpreted by the California courts.

D. Identification of Revenues to be Surveyed

1. Revenues Excluded from this Study

For purposes of this report, we are excluding certain General Fund revenues from consideration. Some revenues have been excluded because they would not generate significant additional revenues. Fines, forfeitures and penalties fall into this category, as do interest and rent. Other revenues are excluded from consideration because increases in the revenue would require changes in State law affecting <u>all</u> local governments. These revenues include primarily inter-governmental revenues, such as State subventions of motor vehicle license fees and gas taxes. The general focus of this report is on revenues that can be controlled by some form of local action.

We also have not focused our attention on State or Federal grants, as there are few programs that would assist with the projects identified in connection with this report. The City may qualify for modest amounts under recent State general obligation bond authorizations for libraries and parks, but not to the extent that they would significantly reduce the needs already identified.

Another potentially significant source of financing beyond the scope of this report is private investment, which can range from conditions imposed on development, such as a storm drainage upgrade, to acts of private philanthropy, such as a gift to enlarge a branch library.

2. Revenues Largely <u>Within</u> the Control of City/Voters

Revenues within the control of the City and/or its voters are the key focal point of this study. They include the following: transient occupancy taxes (TOT), business license taxes, tax overrides for bonded indebtedness, local sales taxes, utility-related revenue, benefit assessments, special taxes (such as a parcel tax), and certain fees – particularly for storm drainage and refuse collection.

The table at the end of this section (Table 3) summarizes the City's revenues and identifies which are either within or outside the City and its voters' control. Even among "controllable revenues," however, most, if not all, require a vote, because of the Constitutional limitations of Proposition 13 and Proposition 218 or limitations imposed by the City's Charter.

3. Other Revenues Largely <u>Beyond</u> the Control of City/Voters

We have examined a few revenues that, while largely out of the control of the City Council or local voters, are important to San Diego's revenue structure. For example, we have provided research on the basic property tax rate and the general sales tax, both of which are subject to State legislative action.

3. CONSTITUTIONAL & OTHER LEGAL CONSTRAINTS

As previously noted, the City's revenue-generating ability must be evaluated within the framework of California law. The following are the specific State Constitutional and other legal constraints that exist with respect to the City's revenue-generating capabilities.

A. The Constitutional Debt Limit

Article XVI, Section 18 of the California Constitution limits local governments' ability to incur debt. The Constitution requires that, in order for a city to incur "indebtedness," 2/3^{rds} of the voters must approve a measure, along with a property tax levied to service the debt. State Supreme Court decisions have created various exceptions to the definition of indebtedness: lease agreements that meet certain conditions, revenue bonds paid from enterprise or other special funds under a "special funds doctrine," and "obligations imposed by law," such as pension obligations.

B. Proposition 13

This landmark Constitutional Amendment, adopted in June 1978, added Article XIIIA to the State Constitution. It limited the total property tax rate to 1%, rolled back assessed valuations, and limited annual increases in assessed valuation to 2% unless property ownership changes or there is new construction. The allocation of the 1% total property tax was delegated to the State Legislature. Proposition 13 also introduced the notion of "special taxes ," and the requirement that they be approved by 2/3^{rds} of the voters.

C. Proposition 218

This Constitutional Amendment, presented to the voters as the "Taxpayers' Right to Vote Act" in November 1996, reversed a number of court decisions that had liberally interpreted Proposition 13. Proposition 218 added Articles XIIIC and XIIID to the State Constitution, creating a Constitutional requirement for majority-voter approval of general taxes. Previously, it was generally interpreted that a charter city could increase such taxes simply by city council approval. Proposition 218 also restricted the use of assessments for specific services, raised the standard for determining "special benefits," and introduced a majority-vote requirement for property owners to approve new assessments.

Proposition 218 also introduced the notion of "property-related fees," restricted their use, and required new procedures for their initiation or increase for services other than gas and electricity. In some cases, voter approval for the imposition of such fees is required. In other cases, the fees are subject to mailed notice and public hearing and increasing them can be stopped through majority protest.

While this proposition has been the law of the State for five and half years, there still is much uncertainty to its precise meaning due to limited court interpretation. Most cities long ago concluded that water, sewer, and refuse collection fees are not "property-related fees," a position upheld by an opinion of the State Attorney General. Last year, the California Supreme Court seemed to affirm that interpretation (*the Apartment Owners Association of Los Angeles County, Inc.*). The Court found that the fee provisions of Proportion 218 applied only if property ownership alone is the basis for the liability, and if the fee can be avoided only by selling the property. In April 2002, however, the State Court of Appeal for the Third District rendered a ruling that found that the water, sewer and refuse fees of the City of Roseville were property-related fees subject to the restrictions of Proposition 218 (*Howard Jarvis Taxpayers Association v. City of Roseville*). Subsequently in June 2002, the State Court of Appeal for the Sixth District found that the City of Salinas's storm drainage fees were invalid under Proposition 218 because they were imposed without voter approval (*Howard Jarvis Taxpayers Association v. City of Salinas*.) Given the dynamic nature of this area of law, the City should consult with its own attorneys before reaching a conclusion in this area.

D. The Gann Limit

Article XIIIB of the Constitution, approved by the voters in 1979 and subsequently amended by Propositions 98 and 111 (together, commonly referred to as the "Gann Limit"), limits the annual appropriations of the State and local government to the level of appropriations for the prior fiscal year, as adjusted primarily for changes in the cost of living and in population.

The revenues whose appropriation are subject to Article XIIIB limitations are primarily the "proceeds of taxes" levied by or for that entity and the proceeds of certain State subventions to that entity. "Proceeds of taxes" include all tax revenues, the proceeds from fees to the extent that they exceed the reasonable costs in providing the service, and the proceeds from investment of tax revenues. Appropriations for "voter-approved debt service" and "qualified capital outlay projects" are not subject to limitation. Because of an absence of case law, the precise definition of these terms is open to interpretation.

While local voters can increase a local government's Gann limit through a simple majority vote, that increase is in effect for only four years.

For the 2001-2002 Fiscal Year, the City's Gann limit was calculated to be \$603,258,862. Appropriations subject to limit totaled \$559,473,004. The current gap of \$43,785,858 is relatively narrow, and could produce a constraint on raising new taxes. It will be important that the new expenditures associated with the capital program be construed as either "qualified capital expenditures" or "voter-approved debt service" under the definitions of the Gann limit, so that these appropriations can be excluded from the calculation.

E. City Charter & Municipal Code

Under California law, a city that was incorporated under its own charter generally has the powers granted to it by its charter, so long as these powers do not conflict with the State Constitution. Although San Diego is a charter city, its control over local revenues has been eroded over the past 25 years. The propositions noted above have amended the Constitution to limit charter city powers of revenue-raising. Additional limitations can be imposed by State statute if the matter is of "statewide concern," a definition that seems to broaden over time.

Additional restrictions on a city's revenue-generating capabilities or financing powers may also be introduced by local law. For example, San Diego's charter was amended in 1998 to require simple-majority voter approval for "major public projects" (costing more than 10% of the City's General Fund Budget) conferring "significant private benefit." A long-standing feature of the City's statutes (Municipal Code Section 66.0123, approved by the City's voters in 1919), prohibits the City from charging a fee for residential refuse collection and disposal.

A proposed amendment to the San Diego City Charter would have significant impact on the financing of the capital projects that are the subject of this report. Proposition E, a local initiative titled "The San Diego Taxpayers' Protection Act," would raise the voter-approval threshold to a 2/3^rds^ majority for even a general tax, an even more stringent requirement than that imposed by State law. While this matter was approved by a majority of voters on March 5, 2002, a competing measure was also approved at that election that was intended to prevent Proposition E's implementation. Proposition F would require that any ballot measure "requiring a greater than simple majority vote of the electorate, and which is proposed to be adopted on or after the date of this election, must be adopted by the same proportionate vote of the electorate." The reconciliation of these two measures is the subject of current litigation, and may not be resolved for several years.

4. POLICY AND POLITICAL CONSIDERATIONS

The discussion above surveys the legal restrictions governing municipal revenues. In addition, City policymakers must evaluate the policy implications of any proposed financing program, such as who pays and who benefits, as well as the political implications–what options are most likely to garner sufficient support for their implementation. The City must also evaluate the ease of collection of a new tax, assessment or fee. If the administrative costs are significant, the revenue option may lose its attractiveness. For example, utility users taxes are relatively easy to collect through utility bills, but the same may not be true for business license fees involving complex calculations. The following outlines some key areas for consideration in determining the optimal mix of revenues.

- **Defining the Beneficiaries**. The capital improvements identified as necessary to bring the existing urbanized communities up to the current General Plan standards would generally be defined as "local improvements" serving residents of those communities, rather than as "regional infrastructure." On the other hand, the incentive for the current focus on these improvements is to engender acceptance of higher densities in these neighborhoods and thereby reduce the urban sprawl that would place additional burdens on regional infrastructure.

- **City-Wide or Local Revenues.** Some of the financing options under consideration would have City-wide impact, such as the issuance of general obligation bonds paid from a property tax override or the increase in utility-based revenues. Other financing options could be targeted at specific neighborhoods, such as the creation of assessment districts serving specific neighborhood needs.

- **User Fees or Taxes.** Some of the revenues under consideration are targeted at the users of a specific city service; refuse collection fees or local assessments represent two examples where the exaction is designed to reflect the specific cost of the service to the payer. Taxes, such as property taxes and sales taxes, are broadly applied on a basis unrelated to the benefits of a specific service or capital improvement. There are sound public policy arguments favoring both approaches to funding local government. To the extent the City currently finances a service such as refuse collection out of its general revenues, replacement with user fee-based financing would free up those general revenues for capital or other purposes.

- **Residential or Business Payers.** Different types of levies place a burden on different sections of the community. Ad valorem property taxes are exacted against all property owners; accordingly, about 40% of such property taxes are paid by businesses. A residential refuse collection fee would be paid only by residents in single-family homes or small apartment buildings. (Businesses already pay private haulers for their refuse collection.)

- **Local or Visiting Taxpayers.** Members of the Committee expressed particular interest in taxes that might be paid by visitors to the City, such as sales or transient occupancy taxes, as they could serve to lighten the total tax burden on residents.

- **Federal and State Tax Implications**. Certain taxes and other charges are deductible from Federal and State income taxes, reducing the financial burden of any increase. This is most notable for property taxes. Business taxpayers can deduct virtually all charges to which they are subjected. Residential taxpayers can only deduct property taxes.

- **Timing of New Revenues**. A number of the financing alternatives outlined in this report could lend themselves to a phased implementation. For example, the City could seek voter authorization of a certain amount of general obligation bonds now, and seek a second authorization in five to ten years.

- **Equity Issues**. There may be a number of other public policy issues that the City will want to address as it contemplates a plan of finance. For example, property-based taxes are often viewed as "progressive," under the presumption that property value is a measure of wealth and therefore of the taxpayer's ability to pay. Sales taxes are often viewed as "regressive," as lower income taxpayers typically pay a larger portion of their income in such taxes.

- **Simple Majority or 2/3rds Voter Approval**. The State Constitution requires a higher voter approval threshold for taxes for specific purposes (special taxes) than it does for taxes that are not earmarked (general taxes). While voters generally respond more favorably to taxes specifically dedicated to programs of high priority, such taxes must receive 2/3rds approval. The threshold for approval of general taxes under state law is only a simple-majority, but their unrestricted use makes them less appealing. At least one jurisdiction (Santa Clara County) addressed this dilemma by placing two simple-majority measures on the same ballot: approval of a general tax, and an advisory measure as to how any additional revenues should be used. While this strategy was found legal by the State Supreme Court, it has not been reviewed in light of Proposition 218, which attempted to prevent this approach.

  Non-tax revenues, such as fees and assessments, often have voter-approval requirements as well. When voter approval is required, it usually is a simple majority. These requirements are discussed throughout the report.

- **Competing Municipal Priorities.** The purpose of this report is to explore options for financing a specific set of needs. There are a large number of other local and regional infrastructure improvements and potential increases in municipal services that also merit consideration. In evaluating these financing options, and in implementing specific alternatives, City decision makers will have to strike a balance between the specific capital needs identified in the urbanized communities, and the other needs throughout the City of San Diego.

The following table summarizes revenues within the control of the City or its voters and the legal constraints on increasing such revenues:

Table 3

Major Revenues Within Control of the City Council/Voters

Tax/Fee	Voter Requirement [1]	Basis of Levy
Ad Valorem property Tax	2/3 rds	City-wide, based on assessed value of property. An increase of the tax rate above 1% is limited to servicing bond debt service.
Sales & Use Tax [2]	50% if levied for general purposes[2]	City-wide, as a % of taxable retail and business-to-business sales.
Transient Occupancy Tax	50% if levied for general purposes[3]	City-wide, as a percentage of hotel room rate. Primarily derived from visitors.
Business License Tax	50%	City-wide, although specific rates could reflect policy priorities.
Utility Users Tax	50%	City-wide, as a percentage of utility bill.
Franchise Taxes/Fees	Set by negotiation with individual utilities	While directly levied on utilities, effect would be City-wide.
Transfers from Municipal Utilities (e.g., right-of-way fees)	None, although may be vulnerable to Proposition 218 challenge	Effect would be City-wide.
Real Property Transfer Tax	50%	Levied on property sales.
Parcel Taxes (including Mello-Roos)	2/3rds (vote can be by property owners, if less than 12 registered voters)	Can be levied City-wide or locally.
Storm Drain Fees	Unresolved under Proposition 218; probably 50%	Most likely City-wide. Current City practice is to levy a per parcel fee on the water and sewer bill.
Refuse Collection Fees	50% to amend the City Municipal Code	City-wide, on residential collection.
Benefit Assessments	50% of property owners	Levied on property within a benefit assessment district. Based on a calculation of the special benefit received.

[1] Based on State law. A recent City proposition would require 2/3rds voter approval on all *tax* increases, although its implementation is the subject of current litigation. See Section 3E discussing local legal constraints on revenues.

[2] There is a statutory provision for County-wide local sales tax. A City-wide tax would require special legislation, which has occurred from time to time.

[3] Sometimes levied as a special tax, requiring 2/3 rds voter approval.

Source: Kelling, Northcross & Nobriga.

PART II - MAJOR REVENUE CATEGORIES

PART II - MAJOR REVENUE CATEGORIES

5. MAJOR REVENUE CATEGORIES

A City's General Fund is the main accounting category for revenues used for general governmental purposes, although there is some variation among cities as to which revenues are deposited into the General Fund. Per capita General Fund revenues represent one proxy for the relative "size" of government with respect to the demand for municipal services. As shown below, San Diego ranked 9th out of 13 among the California peer group cities in this category (excluding San Francisco, which is a combined city and county and receives the property taxes attributable to both). San Diego's per capita General Fund revenue is only half of Santa Clara's; Santa Clara has the highest per capita General Fund revenue (excluding the City and County of San Francisco). Since General Fund revenues derive largely from taxes, this is one indicator that San Diego's population is lightly-taxed, relative to the level of services delivered, when compared to many of its peers.

Table 4

California Peer Group Cities
General Fund Overview
Per Capita General Fund Revenue
(Ranked by Revenue Per Capita)

City	General Fund Revenue	Population	Revenue Per Capita
San Francisco[1]	$1,859,860,000	793,700	$2,343
Santa Clara	116,054,000	104,600	1,110
Oakland	368,142,000	402,100	916
Santa Barbara	75,425,802	92,325	817
Los Angeles	2,865,425,000	3,802,700	754
Irvine	100,003,000	150,100	666
Long Beach	298,600,000	473,600	630
Sacramento	250,367,000	418,700	598
San Jose	514,247,000	918,800	560
San Diego[2]	668,576,000	1,227,168	545
Anaheim	171,047,000	336,300	509
Santa Ana	152,768,832	348,100	439
Fresno	155,913,000	427,652	365
Bakersfield	92,619,962	254,400	364

[1] San Francisco's totals include both its revenues as a county and city.

[2] San Diego's General Fund revenue has been adjusted to reflect certain unique elements of the City's accounting. The General Fund total includes the Environmental Growth Special Revenue Fund (which receives franchise fees), the Police Decentralization Special Revenue Fund (which receives a portion of the City's sales tax revenues), and the sales tax revenues deposited in the Transient Occupancy Tax Special Revenue Fund.

Source: 1999/00 Comprehensive Audited Financial Reports and January 1, 2001 California Department of Finance estimates.

For San Diego's out-of-State peers, a similar pattern emerges. San Diego ranks second-to-last among all peer group cities in per capita General Fund revenues. Further, revenues are less than half of Seattle's, which has the highest ratio among the five. (Because Denver is both a city and a county, like San Francisco, its totals are misleading.)

Table 5

Out-of-State Cities
General Fund Overview
Per Capita General Fund Revenue
(Ranked by Revenue Per Capita)

City	General Fund Revenue	Population	Revenue Per Capita
Denver	$632,732,000	507,500	$1,247
Seattle	641,636,000	563,374	1,139
Phoenix	739,054,000	1,289,125	573
Portland	368,725,339	512,395	720
San Diego[1]	668,576,000	1,227,168	545
Austin	319,745,000	628,667	509

[1]San Diego's General Fund revenue has been adjusted to reflect certain unique elements of the City's accounting. The General Fund total includes the Environmental Growth Special Revenue Fund (which receives franchise fees), the Police Decentralization Special Revenue Fund (which receives a portion of the City's sales tax revenues), and the sales tax revenues deposited in the Transient Occupancy Tax Special Revenue Fund.

Source: Comprehensive Annual Financial Reports for 1999/00.

With these comparisons as a backdrop, San Diego's General Fund revenues need to be examined within the context of how each of San Diego's revenue sources compare with similar cities; whether increases of these revenues are within the control of the City Council or its voters; and how revenue generation may support specific financing options.

Note that while the focus of this report is on identifying funding for public facilities in San Diego's urbanized communities, those facility needs are also competing with other City priorities for limited municipal resources. As such, additional revenue the City receives in the future may not be used exclusively to fund capital improvements associated with the Strategic Framework Element, but rather may be shared among many competing priorities. The following is a detailed discussion of San Diego's major General Fund revenue sources, as well as other revenue mechanisms that merit consideration by the City.

A. Property Tax

Background & Definition. Property taxes on real and certain tangible personal property have been a traditional source for financing local government since our nation was founded. But in California during the 1970's the electorate perceived that these local taxes had become excessive, in light of the effect of rapid inflation on assessed values and large and growing State budget surpluses. This dissatisfaction culminated in a "taxpayers revolt" in the form of the Jarvis-Gann initiative which qualified for the ballot in December, 1977. The subsequent passage of Proposition 13 in June, 1978 amended the State Constitution by adding Article XIIIA. This amendment put restrictions on the growth of assessed valuations, and limited the property taxes that could be levied among all local jurisdictions to a maximum rate of 1% of assessed valuation. Tax overrides to pay for existing voter-approved indebtedness (General Obligation bonds) could be in excess of the 1% limit. A subsequent amendment to Proposition 13 passed in 1986, Proposition 46, permitted overrides for new general obligation bonded indebtedness, as well.

Basis for Collection. The allocation of the 1% maximum rate among overlapping taxing jurisdictions is subject to State legislative control. Property taxes are collected by the county, and allocated to cities, counties, schools and special districts by statutory formula. The basis for allocation under the existing formula is the average tax rate levied by the taxing agency for the three years before Proposition 13 was adopted (referred to as "the AB 8 formula"). This original allocation reduced the proportionate share of property taxes received by schools, to the benefit of cities, counties and special districts. During 1992 and 1993, the State rolled-back this "bailout," reducing city tax receipts.

Observations Among Peer Group Cities. Because of its low tax rate at the time of the passage of Proposition 13, San Diego receives a relatively smaller allocation (17.1%) of the 1% than many of its peer group cities.

Table 6

California Peer Group Cities
Comparative Property Tax Receipts
(Ranked by % of Tax Base)

City	% of One-Percent Base Tax	Revenue	% of General Fund Revenues	Property Tax Revenue Per Capita
San Francisco[1]	70.5%	$405,560,000	22%	$511
Oakland[2]	33.2	85,872,000	23	214
Los Angeles	28.9	527,434,000	18	139
Sacramento	28.1	46,596,000	19	111
Fresno[2]	24.6	40,061,061	26	94
Long Beach	23.7	44,160,000	15	93
Bakersfield	20.8	18,640,000	20	73
Santa Ana	19.8	18,186,828	12	52
San Diego	17.1	144,288,000	22	118
San Jose	14.7	71,970,853	14	78
Santa Barbara	12.1	8,126,664	11	88
Anaheim	11.5	17,800,000	10	53
Santa Clara	11.0	30,813,000	27	295
Irvine	6.0	16,917,000	11	73

[1] San Francisco's total reflects its allocation as both a city and a county.

[2] These cities receive additional property taxes for pension obligations approved by voters before Proposition 13. Percent of 1% allocation figures exclude but revenue figures include this additional property tax overrides revenues.

Source: State Legislative Analysts data base, and 1999/00 Comprehensive Annual Financial Reports.

Equity & Policy Issues. Traditionally, taxation based on the value of property has been considered a form of progressive taxation in that wealthier individuals in society carry a relatively heavier burden of taxation. Certain inequities were arguably introduced by the assessment methodology of Proposition 13, which tends to burden new property owners disproportionally as compared to long-term property owners, because property is re-assessed to current market levels only with changes in ownership. Otherwise, the maximum annual increase in assessed valuation permitted by Proposition 13 is 2% annually.

Options to Increase. Changing the 1% overall tax would require a State Constitutional amendment (50% State-wide voter approval). Changing the allocation of the 1% among overlapping jurisdictions could be accomplished by new legislation at the State level. The City may choose to lobby the State Legislature for a new allocation formula.

B. Voter-Approved Property Tax Overrides for Bonded Indebtedness

Background & Definition. Proposition 13 eliminated the authority for local governments to levy supplemental property taxes to pay debt service for new General Obligation bonds; it provided only for the levy of taxes for indebtedness already approved by the voters at the time the proposition passed. Thus, in the eight years immediately after Proposition13 became law, local governments no longer had access to issuing new General Obligation bonds to finance needed capital improvements. Rather, governments were forced to rely on General Fund-type obligations, such as lease revenue bonds and certificates of participation, to finance general purpose capital projects. These obligations are paid from the General Fund, and do not generate any new taxes as a revenue and repayment source.

Proposition 46, approved by the voters in 1986, once again allowed for the necessary property tax overrides to service General Obligation debt, if approved by 2/3^{rds} of the voters. General Obligation bond proceeds can only be used to finance the acquisition and construction of real property. Proceeds cannot be used to finance the acquisition of equipment or other personal property.

Basis for Collection. An annual tax rate is set sufficient to pay debt service on outstanding General Obligation bonds of a local government. The tax is collected on the local tax rolls along with the 1% levy. However, the tax is not allocated by the AB 8 formula. It simply goes to the jurisdiction that passed the corresponding General Obligation bond measure with a 2/3^{rds} vote.

Observations Among Peer Group Cities. The following table shows the prevailing tax overrides to service General Obligation bonded indebtedness among the in-State peer group cities as of June 30, 2000. Among cities with General Obligation bonds outstanding, San Diego ranked fifth in the total tax rate.

It is important to note that General Obligation bond financing is not the most common form of debt financing for general governmental purposes among California cities. San Diego and most other major cities in the State have financed such projects primarily through the sale of lease revenue bonds and certificates of participation, which are typically repaid out of annual general fund appropriations.

Table 7

California Peer Group Cities
With Outstanding General Obligation Bonds
(Ranked by Tax Rate)

City	Tax Override Rate %	G.O. Bonds Outstanding	Outstanding as % of Assessed Valuation	Outstanding Per Capita
Oakland	0.197%	$ 138,205,000	0.66%	$ 344
San Francisco[1]	0.136	877,655,000	1.12	1,106
Los Angeles	0.036	604,520,000	0.28	159
San Diego[2]	0.007	68,700,000	0.02	56
Irvine	0.006	2,120,000	0.01	14
Anaheim	0.004	8,535,000	0.04	25
Sacramento	0.002	310,000	0.00	1
Bakersfield	NA[3]	7,090,000	0.07	22

[1] Includes levy for unified school district bonds.

[2] Tax rate is for Public Safety Communication Bonds, Series 1991 only. The City's Open Space Park Refunding Bonds Series 1994, which are also General Obligation Bonds for which a property tax could be levied, are in practice serviced out of franchise fees. In addition to General Obligation bonds, as of June 30, 2000, San Diego had $399,700,000 in lease revenue bonds and Certificates of Participation outstanding.

[3] This issue is serviced by the Agriculture Water Enterprise Fund.

Source: 1999/00 Comprehensive Annual Financial Reports and California Municipal Statistics, Inc.

Some of San Diego's in-State peers, do not have any General Obligation bonds outstanding, as shown below:

Table 8

California Peer Group Cities
Without Outstanding General Obligation Bonds

Fresno	Santa Ana
Long Beach	Santa Barbara
San Jose	Santa Clara

Source: 1999/00 Comprehensive Annual Financial Reports.

Among the cities with General Obligation bonds, San Francisco had more than $850 million and Los Angeles more than $600 million in debt (as of June 30, 2000), compared to San Diego's approximately $69 million. The purposes for which these bonds were issued are shown in the following table:

Table 9

California Peer Group Cities

G. O. Bonds by Purpose

City	G. O. Bonds by Purpose
Anaheim	Storm drainage.
Bakersfield	Water improvements.
Irvine	Park improvements.
Los Angeles	Fire facilities, libraries, police facilities, zoo improvements and seismic safety retrofit
Oakland	Seismic safety retrofit, cultural facilities, recreational facilities, libraries.
Sacramento	Flood and drainage.
San Francisco	Libraries; park, recreational and zoo facilities; seismic retrofit; public convalescent hospital; unified school district.
San Diego	Public Safety Communications. Voters also approved Open Space Bonds, but these are being serviced by payments of SDG&E franchise fees rather than a property-tax override.

Source: 1999/00 Comprehensive Annual Financial Reports.

It should be noted that since June 2000, Los Angeles has approved an additional 1.133 billion for animal shelter, police, fire and other public facilities, and San Jose has approved $599 million (through three different measures) for library, recreation and parks, and police facilities.

Data for the Out-Of-State peer group cities shows, in most cases, greater use of general obligation bonds. In these states, only simple-majority voter approval is required to approve general obligation indebtedness, rather than the 2/3 approval required under California law. (Because of this higher voter requirement for G.O. bonds, California cities often favor lease-backed debt, as discussed in Chapter 6-B, below.)

Table 10

Out-Of-State Cities
G.O. Bonds Outstanding by Purpose

City	Purpose
Phoenix	Sewer, water, solid waste, misc. unspecified
Portland	Water, arena, street car, convention center, stadium, performing arts center
Austin	Erosion, & flood control, streets, public safety, libraries, arts center and parks
Seattle	Fire, police, convention center, concert hall, parking garage, coliseum and other
Denver	Park & recreational facilities, library, public safety, health care, and street improvements

Source: Comprehensive Annual Financial Report for 1999/00.

Equity & Policy Issues. The use of property tax overrides to finance capital improvements has all the advantages and disadvantages of the levying of ad valorem property taxes under the 1% general tax rate. Property taxes can be deducted from individual and business State and Federal income taxes. They are levied based on the valuation of property, which can be a proxy for wealth, making property taxes a so-called "progressive" form of taxation. Under Proposition 13, questions of equity arise, because properties of equal market value may have widely different taxable assessed valuations, depending on the changes of ownership that have taken place. These inequities can disproportionately burden homeowners in new developments, which may also be subject to Mello-Roos special taxes or assessments.

Increasing property taxes to service general obligation bonds would generate the largest federal and state tax benefits to taxpayers, as these taxes are deductible for individuals as well as businesses, effectively reducing the net local tax burden.

Options to Levy or Increase. Passage of a General Obligation bond issue to produce a property tax override requires 2/3^{rds} voter approval. (Recently, after several attempts, State voters approved Proposition 39, a constitutional amendment to lower the voter requirement for certain K-14 school and community college General Obligation bonds to 55%.) The 2/3^{rds} voter requirement remains a high hurdle to clear in considering this form of financing. The City may want to engage a public opinion research firm to conduct a poll to determine voter attitudes towards a General Obligation bond measure. Such polls typically test such questions as: (1) what is the maximum tax rate generally deemed acceptable to voters? and (2) for what types of projects would voters be willing to cast an affirmative vote?

Possible Fiscal Impact: Based on San Diego's current assessed valuation, a property tax rate of five cents per $100 of assessed value would generate about $44 million a year in revenues. This would be sufficient to support about $600 million in general obligation bonds (if issued for 30 years at 6%

interest). For a median home *price* of $305,000, this translates to $152.50 per year. (For a house with an average *assessed* value of $202,613, the tax would be $101.32 a year.) The above figures will vary depending on changes in assessed valuation, actual interest rates and whether the bonds are sold in a single or in multiple series.

C. Sales and Use Taxes

Background & Definition. Sales and use taxes are collected on the total retail price of tangible personal property sold, unless specifically exempted. The State Legislature establishes the tax rate. Effective July 15, 1991, the statewide tax rate became 7.25% (up from 6%). Currently, 0.25% of the State tax rate may be terminated upon certification by the State Director of Finance by November 1 in any year that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25% rate can be reinstated if the State Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues. Pursuant to this law, a 0.25% cut in the State sales tax occurred on January 1, 2001, but was reinstated in 2002.

One percent of the sales tax collected by the State is collected on behalf of cities (or, for unincorporated areas, on behalf of counties). Allocation of this local component is on the basis of "situs," or the point of sale. State law also allows for local supplemental sales taxes to be approved on a County-wide basis, which is most commonly collected for transportation purposes. A half-cent sales tax was approved for San Diego County, a portion of which is allocated directly to the City of San Diego. Cities can only levy a supplemental sales tax with special State legislation and with a vote of the local electorate.

In 1993, in response to the Legislative "shifting" of property taxes away from cities and counties to schools, Proposition 172 was placed on the State-wide election ballot to raise the sales tax by ½ cent to fund public safety services. The majority of these public safety funds are allocated to counties. San Diego received $5.4 million of these supplemental sales tax revenues in FY 2000.

The State distributes sales taxes collected within the City as follows:

State General Fund		5.50%
City		1.00
County (for transportation)		0.25
Public Safety Augmentation		0.50
TransNet (local transportation)		0.50
	Total	7.75%

Basis of Collection. The sales tax is collected by retailers selling tangible personal property in California. The use tax is imposed on the user of a product purchased out-of-state and delivered for use in California. A significant portion of these taxes may be assessed against "business-to-business" sales, for property such as manufacturing and information technology equipment.

Observations Among California Peer Group Cities. The following table shows the General Fund sales tax receipts of each city, as well as a measure of receipts per capita and the percent of General Fund revenues contributed by sales and use taxes.

Table 11

California Peer Group Cities
Sales Tax Revenues
(Ranked by Per Capita Revenue)

City	Revenue	Per Capita	% of General Fund
Santa Clara	$ 43,444,000	$415	37.4%
Irvine	43,278,000	288	43.3
Santa Barbara	17,325,588	188	23.0
San Francisco	133,394,000	168	7.2
San Jose	140,306,536	153	27.3
Bakersfield	38,377,000	151	43.3
Sacramento	59,482,000	142	23.8
San Diego[1]	173,514,000	141	26.0
Anaheim	45,482,000	135	26.6
Santa Ana	41,592,787	119	27.2
Fresno	49,661,000	116	31.9
Oakland	38,470,000	96	10.4
Los Angeles	330,950,000	87	8.1
Long Beach	35,685,000	75	12.0

[1] Revenue total includes sales taxes deposited into the Transient Occupancy Tax and Acquisition, Improvement and Operation Special Funds. Also includes $5.4 million in public safety sales tax receipts to General Fund. Total General Fund was similarly adjusted.

Source: 1999/00 Comprehensive Annual Financial Reports.

Several factors can influence the level of a city's sales tax generation. One factor is the composition of the tax base, particularly the extent that the amount of taxable sales is increased by non-retail transactions such as the sale of manufacturing and business equipment to other businesses. For example, in Anaheim and Santa Clara, business-to-business sales account for 51% and 47%, respectively, of all taxable sales, inflating those cities' per capita sales tax income. San Diego's non-retail sales are a more typical 31%.

In addition, the wealth of a community can influence the relative level of consumption. One common measure of wealth is "Effective Buying Income" ("EBI"), also referred to as "disposable" or "after tax" income. EBI is comprised of a household's personal income less personal tax and certain non-tax payments.

The following table attempts to measure these two factors for the California peer group cities

Table 12

California Peer Group Cities
Taxable Sales and Effective Buying Income
(Ranked by % of Non-Retail Sales)

City	Non-retail as % of Total Taxable Sales	Median Household Effective Buying Income
Anaheim	51%	$48,411
Santa Clara	47	67,269
Irvine	45	64,556
Santa Ana	42	41,497
San Francisco	38	49,818
San Jose	35	68,194
Oakland	35	38,602
Sacramento	34	35,757
San Diego	31	44,089
Los Angeles	29	37,321
Long Beach	27	37,641
Fresno	26	29,334
Santa Barbara	22	41,653
Bakersfield	20	37,573

Source: "Taxable Sales In California Sales & Use Tax During 1999," California State Board of Equalization and "2001 Survey of Buying Power," Sales and Marketing Management Magazine.

Another factor behind sales tax generation is the level of taxable sales made to non-residents of a city. Given the level of tourist and cross-border traffic through San Diego, the contributions of such sales could be significant. A study conducted by a local economic research group estimated that approximately 10% of the City's taxable sales were generated by visitors to the City.

Equity & Policy Issues. Many observers have criticized the "fiscalization" of land use, where sales tax generation becomes the dominant goal of land use and economic development policy. Over the past decade, certain California cities have vigorously competed with one another to build shopping and auto malls and "power centers" to grow their retail tax bases. Some critics, such as SANDAG, believe that this retail development has been at the expense of the building of affordable housing.

Options to Increase. Statewide sales and use taxes could be increased by the Legislature. Additional local sales taxes for special purposes can be levied by counties, up to an aggregate total of 1.0%. We are aware of 15 cities that have obtained special State legislation allowing them to levy a supplemental sales tax. All but one of those statutes required that the local tax be approved by a two-thirds majority. Seven such city sales taxes have been approved, all by a two-thirds majority, and are summarized in the table below.

Table 13

California City Sales Taxes

City	Supplemental Sales Tax Rate	Purpose
Avalon	0.50%	Municipal hospital
Calexico	0.50	Hospital district
Clearlake	0.50	Public safety services
Clovis	0.30	Police and fire facilities
Placerville	0.25	Police services
Truckee	0.50	Streets and roads
Woodland	0.50	No restriction

Source: State Board of Equalization.

Possible Fiscal Impact: If the City were to levy a 0.25% local sales tax, it would generate about $42 million a year. This analysis is based on sales tax receipts of $168 million currently allocated to the City from the 1% local share.

D. Transient Occupancy Tax

Background & Definition. Also known as a “bed,” “room” or “hotel” tax, this tax is imposed on visitors for the privilege of occupying rooms in hotels, motels, inns and other lodging facilities for 30 days or less. Statewide, about 83% of all cities levy this tax.

Basis for Collection: The tax is collected by hotels and other lodging facilities, typically as a percent of the consumer's total lodging bill, before taxes.

Observations Among Peer Group Cities. San Diego has a lower transient occupancy tax rate (TOT) than most of the cities in its California peer group, particularly Anaheim (15%), San Francisco (14%), and Los Angeles (14%), which are competitors for tourism and business travel.

Table 14

California Peer Group Cities
Transient Occupancy Tax

City	Rate
Anaheim [1]	15.0%
San Francisco	14.0%
Los Angeles	14.0%
Long Beach	12.0%
Fresno	12.0%
Bakersfield	12.0%
Santa Barbara [2]	12.0%
Sacramento	12.0%
Oakland	11.0%
San Diego	10.5%
Santa Clara	10.0%
San Jose	10.0%
Santa Ana	9.0%
Irvine	8.0%

[1]In 1995/96 the rate was increased from 13% to 15%. Funds were earmarked for infrastructure improvements relating to Disneyland's expansion.

[2]In 2000 an increase from 10.2% to 12% was approved (with 2/3rd vote) for creeks restoration and water quality improvements.

Source: Individual Revenue Manager Interviews and 1999/00 Comprehensive Annual Financial Reports.

Equity &Policy Issues: The TOT is usually viewed as one of the easiest taxes for which to gain voter approval, since it is typically levied on non-residents. However, a relatively high tax rate may reduce the competitiveness of the local hotel market and negatively impact convention and business travel and tourism. The San Diego City Council has adopted various policies regarding this tax, including one stating that San Diego's tax not exceed a calculation based on the average rate of 15 designated cities. In 1998, that maximum rate was 13.1%. This policy could be amended by subsequent Council action.

Options to Increase: After Proposition 218, a simple-majority vote has been required to increase the TOT. In addition, since the passage of Proposition 13, a TOT levied for a specific purpose (such as financing tourist promotion, or creeks restoration and water quality improvement as in the case of Santa Barbara) has required 2/3^{rds} voter approval as a "special tax."

Possible Fiscal Impact: Based on receipts of $96.8 million at a rate of 10.5%, a 1% increase in the TOT would yield $9.2 million.

E. Business License Tax

Background & Definition. A business license tax is a type of excise tax imposed on businesses for the privilege of conducting business within municipal boundaries.

Basis for Collection. State statutes allow for the collection of business license taxes, which are set by local jurisdiction. Most commonly, the tax is based on gross receipts or on the number of employees. Different rates are often set for different kinds of businesses, e.g., manufacturing, retail or service (and even for different kinds of services). Often tax rates reflect a sliding scale depending on business size. Alternative methodologies include flat rate, quantity of goods produced, percentage of payroll, number of vehicles, square footage of the business, or some other combination of factors. State law prohibits rates that are discriminatory or confiscatory.

San Diego levies a business tax that is based on number of employees, distinguishing between small and larger business. The City charges a flat rate of $34 for a business with less than 12 employees, and $125 plus $5 per employee for larger businesses. City staff estimates that there are 2,000 firms with 13 or more employees in San Diego, with 250,000 effected employees.

Observation Among Peer Group Cities. Over 90% of cities in California charge some form of business tax. Of the cities we surveyed for whom this tax represents a significant share of revenues (over 3% of general fund), all had a tax based on revenues or, in the case of San Francisco, payroll.

Equity & Policy Issues. Business taxes reportedly can affect business location and expansion decisions.

Table 15

California Peer Group Cities
Business License Tax
(Ranked by % of General Fund)

City	Business Tax Revenues	% of General Fund	Per Capita[1]	Basis
San Francisco	$267,197,000	14.4%	$336.65	1.5% of payroll.
Los Angeles	319,231,000	11.1	83.95	Gross sales, ranging from 0.13% to 0.83%.
Oakland	35,845,000	9.7	89.14	Gross receipts, ranging from 0.06% to 1.39%. For most industries, 0.1 to 0.2%
Fresno	11,908,700	7.4	27.85	NA
Santa Ana	6,621,935	3.7	19.02	Gross receipts, ranging from 0.15% to 0.077%.
Anaheim	4,835,298	2.8	14.38	Gross receipts for manufacturing and retail (0.95%) and per employee for services ($10) and professionals ($75); minimum fees of $60 to $150.
Sacramento	5,410,000	2.2	12.92	0.04% of gross receipts, with $5,000 maximum.
San Jose[2]	11,500,000	2.2	12.52	Per employee ($18 per employee over 8).
Long Beach	7,751,503	2.1	16.37	Base rate + per employee fee, ranging from $6.34 to $19.03.
Bakersfield	1,942,796	2.1	7.64	Gross receipts at 0.03% to 0.065%.
Santa Barbara	1,733,400	2.1	18.77	Annual fee, based on ranges of gross receipts. About 0.02% to 0.04%.
San Diego	4,700,000	0.7	3.83	Per employee basis. Flat rate of $34 for business with less than 12 employees. For larger business, $125 plus $5 per employee.
Irvine	N/A	Minimal	N/A	$50 per business.
Santa Clara	--	0.0	--	No business tax.

[1]Business tax revenue divided by the City total population.

[2]Excludes card room and refuse disposal taxes.

Source: Comprehensive Annual Reports, Budgets, and interviews with City staff.

Options to Increase: Regulatory fees may be imposed by City Council action. Taxes levied for revenue-raising purposes (which includes San Diego's tax) require simple-majority voter approval under Proposition 218.

Possible Fiscal Impact: It is estimated that doubling all current rates of general business license taxes would generate an additional $4.7 million for the City's General Fund. Each $5 increase in the per employee fee for firms with 13 or more employees would generate $1.5 million a year. If the per employee tax was increased from $5 to $100 for the 2,000 firms with 13 or more employees, an additional $23.7 million would be generated.

F. Utility - Related Revenue

Utility related revenue includes three separate categories of revenue: (1) utility user taxes that appear directly on the consumers' bills for services; (2) franchise fees or charges that are paid by investor-owned utilities for the privilege of using public rights of way and/or conducting their businesses within the boundaries of a municipality; and (3) transfers of income from a municipality's own enterprise operations to the General Fund. Some cities collect revenue from none of these sources, while others collect it from all three.

1. Utility Users Tax

Background & Definition. This tax is authorized by State statute and ordinances. Taxes can be levied on electric, gas, cable, television, water and telephone services. (Some city tax structures distinguish between intrastate, interstate, international and wireless telephone services). Statewide, tax rates range form 0.5% to 12.5%. About 160 of the State's 477 cities levy a utility users tax.

Basis for Collection. The tax is based on a percent of the consumer's utility bill, and is collected by the utility.

Observation Among Peer Group Cities. The following table shows tax rates among California peer group cities.

Table 16

California Peer Group Cities
Utility Users Taxes
(Ranked by % of General Fund Revenue)

City	Revenue	% of General Fund	Utilities Taxed[1]	Rate/Utility/User
Sacramento	$ 42,650,000	17.0%	E, G, TE, TV	7.5%
Santa Ana	21,790,618	14.3%	E, G, TE, W	6%, with a cap at $11,000.
Los Angeles	489,419,000	12.0%	E, G, TE, TV	10.30%
Santa Barbara	8,910,837	11.8%	E, G, TE, TV, W	6%
Oakland	41,592,000	11.3%	E, G, R, TE, TV	7.50%
San Jose	53,425,760	10.4%	E, G, TE, W	5%
San Francisco	56,000,000	5.0%	E, G, S, TE, W	7.50% Commercial accounts only.
Irvine	2,748,000	2.7%	E, G, TE	1.5% up to $5K for Commercial/Industrial customers.
Long Beach	57,396,000	0.2%	E, G, TE, W	9.0% beginning in FY ‘01, down from 10% prior year. Rate to drop 1% per year until 5% in FY 05 according to measure passed on 11/7/00.
Anaheim	None			
Bakersfield	None			
Fresno	None			
San Diego	None			
Santa Clara	None			

[1]E=electricity, G=natural gas, R=refuse collection, S=steam, TE=telephone, TV= cable television, W=water,

Source: Individual revenue manager interviews, 1999/00 Comprehensive Annual Financial Reports, and Budgets.

Equity & Policy Issues. Generally, utility users taxes are viewed as regressive, as lower income families pay a higher proportion of their income on utility bills. On the other hand, business taxpayers represent a significant portion of this revenue source. Recent increases in electricity prices could undermine political support for increasing this type of tax.

Prior to the voter requirement imposed by state law, implementing such a tax could be politically unpopular. In certain cities, utility taxes were rolled back. Referendums in some cities resulted in recalls of elected officials who had supported such taxes. On the other hand, about one-third of all California cities levy a utility users tax.

Options to Increase. Prior to Proposition 218, these taxes were imposed or could be increased by Council action. Now, a simple-majority vote is required.

Possible Fiscal Impact: Most cities with utility users taxes generate $12 to $16 per capita for each 1% of tax rate depending in large measure on which utilities are taxed. The highest per capita revenue is in Santa Barbara, at $16.09. Santa Barbara taxes all major utilities, but its commercial and industrial tax base is proportionately smaller than San Diego's. Assuming $15 per capita in revenue, San Diego would generate about $18.5 million for each 1% of utility users tax if applied against electricity, natural gas, cable television, water and telephone.

2. Franchise Taxes or Fees

Background & Definition. Franchises, which are sometimes characterized as either a fee or a tax, are paid to a municipality from a franchisee as a "rental" or "toll" for the use of city streets and rights-of-way.

Basis for Collection. State statute limits payments from gas and electric franchises to General Law cities to 2% of the franchisee's gross annual receipts arising from the use of the franchise. Charter cities may set fees in excess of the 2% limit. Franchise fees are commonly charged to such utilities as gas, electricity, water, and to companies which conduct business on city streets, such as taxicabs and cable television companies. State law exempts telephone companies and railroads from such charges. Franchise fees are collected pursuant to agreements negotiated with the particular enterprise.

Observations Among Peer Group Cities. As the following table shows, most of San Diego's California peer group cities levy some form of franchise fee on electrical, gas and cable televison utilities. San Diego charges what it calls "Franchise Rents" at 3% of gross sales. Because the City is governed by a local charter, its levy can exceed the statutory limit of 2%. Most of that revenue is collected from San Diego Gas & Electric. The city also collects Franchise Rents from cable and refuse disposal companies. While 25% of the SDG&E receipts are deposited into the Environmental Growth Fund, Franchise Rents still comprise more than 6% of the City's General Fund revenues.

Table 17

California Peer Group Cities
Franchise Taxes or Fees
(Ranked by % of General Fund)

City	Revenue	% of General Fund
San Jose	$30,322,259	5.9%
San Diego	38,597,000	5.8
Irvine	3,452,000	3.5
Bakersfield	2,924,983	3.2
Long Beach	9,050,000	3.0
Santa Ana	4,580,486	3.0
Fresno	3,794,000	2.4
Oakland	9,084,000	2.5
Anaheim	3,949,300	2.3
Santa Barbara	1,634,092	2.2
Santa Clara	1,879,000	1.6
Los Angeles	49,437,000	1.2
Sacramento	1,509,000	0.6
San Francisco	9,404,021	0.5

Source: 1999/00 Comprehensive Annual Financial Reports.

Equity & Policy Issues. Utilities typically pass on such charges to consumers, which are considered "regressive" as lower income families pay a higher proportion of their income on utility bills. These charges are also deductible from the utility's state or federal income taxes, creating an indirect subsidy. An increase in such fees would be subject to negotiation when the current franchises expire.

3. Transfers from Municipal Utilities

Background & Definition. Cities that operate one or more utilities often transfer funds from their Enterprise Funds to the General Fund in amounts that exceed the direct overhead costs of general government in supporting that utility. Such transfers are most commonly made from municipal power and water enterprises, but are sometimes transferred from wastewater, solid waste, golf, parking and natural gas enterprises. Both Proposition 218 and the Gann Amendment raise legal questions as to the extent such transfers violate "cost of service" restrictions, but there is limited case law on this matter.

Basis for Collection. In the examples found in our survey, transfers were made under local charter powers. These transfers are often characterized as franchise fees, payments in-lieu-of taxes, transfers of surplus, return on original investment and, in one case, a voter-approved general tax.

Observations Among Peer Group Cities. For the three cities in our review group that operate electric utilities–Anaheim, Los Angeles and Santa Clara–transfers from utilities provide a significant source of revenues. As part of its current budget, Los Angeles increased the transfer from its electrical utility from 5% to 7% of revenues. San Francisco's general fund also receives revenue from an electricity transfer, approximately $30 million a year from power generated at the Hetch Hetchy reservoir as part of its water system.

Several cities recently phased out transfers. San Diego, which characterized such transfers from its water and sewer enterprise funds as "Right-of-Way Charges," has now completely eliminated this source of revenue. This revenue source contributed $15.8 million a year to the General Fund in 1997, based on a rate of 5% of operations. Los Angeles has eliminated its wastewater transfer. Sacramento was challenged on its transfers by a taxpayer group, and eliminated them as part of a voter-approved measure to replace those charges with a general tax on water, sewer, storm and solid waste enterprises.

The following cities receive General Fund revenues through such transfers.

Table 18

California Peer Group Cities
Transfers from Municipal Utilities to General Fund
(Ranked by % of General Fund)

City	Utilities	Transfer Revenue	% of General Fund
Santa Clara	Electricity	$ 9,456,000	8.1%
Anaheim	Electricity, golf, water and solid waste	12,704,260	7.4
Fresno	Water, sewer, solid waste	8,034,300	5.0
Los Angeles	Power, water	139,500,000	4.9
Long Beach	Natural gas, water	15,508,548	4.7
San Francisco	Airport, water	56,001,881	2.8

Source: 1999/00 Comprehensive Annual Financial Reports and Budgets.

Equity & Policy Issues. Since rates must be set to accommodate such transfers, they indirectly result in higher utility rates. These transfers are often justified on the basis that, if the utility were private, it would generate property taxes and franchise fees.

If new transfers were instituted without a vote, they may be subject to legal challenge. A State appellate court recently ruled that such transfers by the City of Roseville from its water, wastewater and refuse collections were in violation of Proposition 218. This decision found that Roseville's fees were "property- related" under the terms of that Constitutional amendment, and that the transfers exceeded the "cost of service" restrictions on charges against such fees. (It should be noted that Proposition 218 specifically exempts electrical and natural gas utilities.)

Options to Increase. The City may wish to re-examine the legal and political issues regarding Right-of-Way charges or other transfers from its enterprise programs. Proposition 218 issues would need to be addressed by the City Attorney's Office.

G. Real Property Transfer Tax

Background & Definition. Nearly every city in California levies a Real Property Transfer Tax. Most often, they are so-called "conforming" taxes, whereby a county levies a tax at $1.10 per $1,000 of sales price. Subsequently, a city levies a tax at $0.55 per $1,000. The city tax is credited against the amount of county tax due, with the result that both the city and the county each receive $0.55 per $1,000.

Some cities have levied a "non-conforming" tax, at a rate above $0.55 per $1,000. In such cases, there is no credit against the county tax collection. 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 ability of a charter city to levy its own real property sale or transfer tax was challenged and has been confirmed by the State Supreme Court.

Basis for Collection. As provided by statute, the tax is based on the purchase price of property at the time of sale. Most "conforming" taxes are collected from the seller; "non-conforming" taxes are often split between buyer and seller in accordance with local practice and individual real estate contracts.

Observations Among Peer Group Cities. The Table below shows that 9 of the 14 California peer group cities charge only the conforming rate of $0.55 per $1,000. However, for Oakland, San Francisco and Los Angeles, this tax is an important source of revenue in absolute dollar terms. For Oakland, more than 9% of General Fund revenues derive from this tax.

Table 19

California Peer Group Cities
with Non-Conforming Real Property Transfer Taxes
(Ranked by Tax Rate)

City	Rate (per $1,000)	Revenue	% of General Fund
Oakland	$15.00	$34,359,000	9.3%
San Francisco[1]	6.80	69,881,533	3.8
Los Angeles	4.50	87,000,000	2.1
Sacramento	2.75	4,994,000	2.0
San Jose	3.30	NA[2]	NA[2]

[1]Properties valued under $250,000 pay the total conforming rate of $1.10.

[2]Conslidated with a second tax on construction, and reported as a special revenue fund. Combined totals for both taxes were $29 million.

Source: Fidelity National Title Insurance Company and 1999/00 Comprehensive Annual Financial Reports

Table 20

California Peer Group Cities
Without Additional Property Transfer Taxes
(Levying Conforming Rate of $0.55 per $1,000 Only)

Anaheim	Irvine	Santa Ana
Bakersfield	Long Beach	Santa Barbara
Fresno	San Diego	Santa Clara

Source: Fidelity National Title Insurance Company and 1999/00 Comprehensive Annual Financial Reports.

Equity & Policy Issues. With an increase in this tax, San Diego would sacrifice the $0.55 per $1,000 it currently receives under its conforming tax ($5.3 million in FY 2000). Some view this as a progressive tax, since it roughly correlates with property-based wealth. However, purchasers of property also will see the assessed valuation of the property (and property taxes) increased under the provisions of Proposition 13. The increase in Real Property Transfer Taxes can be seen as imposing an additional property tax burden.

Options to Increase. The City would need simple majority voter approval to increase this tax under Proposition 218.

Possible Financial Impact. Based on FY 2000 receipts, a transfer tax equivalent to that of Sacramento's (at $2.75 per $1,000 the lowest of the non-conforming peer group cities) would gross about $26.5 million, netting about $21.2 million a year in additional revenues after deducting the existing $5.3 million in revenues that would be sacrificed with the adoption of a non-conforming tax.

H. Other General Fund Taxes

There are a number of other taxes that are collected by cities to supplement their General Fund revenues. Since the passage of Proposition 218, such taxes would require at least majority voter approval. Although these may not generate large sums of revenues, they could be considered as part of an overall revenue package.

The following are the miscellaneous taxes we have identified and the instances where they are levied among the peer group cities.

Table 21

Other General Fund Taxes

Tax	Peer Cities Levied
Admissions Tax	Fresno, Oakland
Construction or Development Tax	Los Angeles, San Jose
Parking Tax	Fresno, Long Beach, Los Angeles
Rental Car Tax	None. Previously considered by San Diego.[1]

[1]The City of Phoenix taxes rental car companies 2% of gross income from short-term rentals.

Source: Interviews with revenue managers and 1999/00 Comprehensive Annual Financial Reports.

I. Fees for Services

As noted in Section 1 of this report, we have eliminated from our review funding for the City's two largest utility systems: water and sewer. But the City does finance other operations with General Funds that could be financed through fees for service (referred to here as "user fees"). It should be noted that, under the Gann Limit, the transfer of an operating expense from the proceeds of taxes to a fee requires a corresponding adjustment to the Gann limit. To the extent that those replacement revenues are appropriated to capital expenditures, they should likewise be excluded from the Gann Limit.

We have identified two areas that, if user fees were implemented, would make the most significant contribution to financing the City's capital program: storm drainage and refuse collection. The former fee could be used to help finance the storm drainage component of the capital program, while collection of the latter would free-up General Funds that could be reallocated to capital improvements.

Background & Definition. Most local fees are based on general State legal authority (including Article XIIIB of the Constitution, establishing the Gann Limit and Government Code Section 39001), or local charters. Proposition 218 imposed new requirements on "Property-Related Fees and Charges."

Equity & Policy Issues. Generally, fees based on use are viewed as more equitable than taxes, since only the users of a service pay for the service rather than the general public. Some cities institute "life-line" rates for low-income and other qualified households to mitigate the financial impact of these fees on certain categories of citizens.

Observations Among Peer Group Cities. Since Proposition 13, cities have increased their use of service fees to fully recover operating costs.

The following explores the two potentially significant fee sources we have identified.

1. Storm Drains

Increased federal regulation of non-point sources of water pollution, such as storm run-off, have led to an increase in fees levied to finance both operating expenses (such as street sweeping and catch-basin cleaning) and capital improvements to manage drainage.

A number of cities have imposed fees for storm drains. The typical fee is a parcel charge, sometimes adjusted for the area of the parcel and the amount of impervious surfaces, such as parking lots. San Diego currently collects a fee of 95 cents per single family residence and a fee based on water use for multi-unit-residential, commercial and industrial properties. These fees, collected on the City's water and sewer utility bills, generate approximately $6 million a year.

Whether the imposition of storm-drain fees would be a property-related charge under Proposition 218 has been unclear, as the subject was not specifically addressed in the measure. Just recently (June 3, 2002), a State Appeals Court ruled that storm drainage fees imposed in the City of Salinas were invalid because they were not approved by property owners. San Diego attempted to increase its storm drain fees by 125% in 1998 through a Proposition 218 election, but the measure failed to garner the necessary majority approval.

Possible Financial Impact. For each $1 increase a month on single family residential units (and with comparable increase for multi-family and commercial property), approximately $6.3 million can be raised annually.

2. Refuse Collection

Observations Among Peer Group Cities. Most California cities charge for residential refuse collection, either through their franchise agreements with private haulers or, when collected by the municipality itself, directly by the city. *San Diego is the only city among its California peer group cities that does not attempt to recapture at least some of the costs of residential refuse collection and disposal through a fee to residents.* Los Angeles' fee is set below the full cost of services, and is subsidized by the City's General Fund. The other cities recapture all their costs.

The following is a summary of the fee structures of the peer group cities.

Table 22

California Peer Group Cities
Refuse Collection Fees
(Ranked by Rate)

City	Household Monthly Rate[1]	Collection Method
Santa Barbara	$ 22.53	Franchise
Sacramento	21.67	City
Oakland	18.66	Franchise
Long Beach	18.00	City
Fresno	16.44	City
Anaheim	15.20	Franchise
San Jose	14.95	Franchise
San Francisco	14.83	Franchise
Santa Ana	13.61	Franchise
Bakersfield	12.00	Both
Irvine	10.78	Franchise
Santa Clara	9.20	Franchise
Los Angeles[2]	6.00	City
San Diego	0.00	City

[1]Current rates. Some cities offer a variety of capacities. In such cases, rates assume a 32 gallon can.

[2]Los Angeles charges a Sanitation Equipment Charge to recapture a portion of its costs.

Source: Telephone survey by Kelling, Northcross & Nobriga.

Equity & Policy Issues. As discussed above, user fees are generally viewed as more equitable than certain taxes. This is particularly true of refuse collection, since renters typically live in buildings that must pay for commercial collection, and those costs are typically passed on to the tenants. The imposition of fees could however, be viewed as a regressive burden on low and fixed-income residents of single-family homes and small apartments.

Options to Increase. While under Proposition 218, the City could probably institute a refuse fee without voter approval, voter approval would be required by local law. Specifically, majority approval would be required to amend Municipal Code Section 66.0123, enacted by voters in 1919 as "the People's Ordinance," which prohibits the collection of fees for refuse collection or disposal.

Possible Financial Impact. Preliminary analysis indicates that imposition of such a fee could replace approximately \$32.7 million a year in current General Fund appropriations with new revenues, freeing up the General Funds for capital or other purposes. This would require a monthly fee of about \$8.95 (\$107.40 a year) for single-family residential refuse collection (based on an estimated 305,000 residences and small businesses receiving service).

J. Parcel and Other Special Property Taxes

Background & Definition. Parcel taxes are non-ad valorem property taxes, levied for a specific purpose. The most common form of special tax used in California is a tax levied pursuant to the Mello-Roos Community Facilities Act of 1982 (the "Mello-Roos Act"), which authorizes certain public entities to form a Community Facilities District ("CFD"). This method of taxation, as well as benefit assessment districts, has been and would most likely continue to be used by San Diego to create special taxing sub-districts within particular neighborhoods. A City-wide special tax would more likely be implemented under the City's charter powers.

Parcel taxes require 2/3^{rds} voter approval. Under the Mello-Roos statute, property owners can approve a parcel tax if there are less than 12 registered voters.

A local tax district may finance the acquisition, construction or improvement of any real or tangible property with an estimated useful life of five or more years. The financed facilities do not need to be located in the district, which allows a parcel tax to finance regional facilities. Most often, parcel taxes are used to service bonds, the proceeds of which finance the improvements. Examples of the types of facilities which may be financed include:

- Local park, recreation, parkway and open space facilities
- Libraries and child care facilities
- Streets and street-related improvements
- Facilities for flood and storm drain protection purposes

- Work to bring buildings to seismic safety standards

Parcel taxes also may be used to fund certain services, such as:

- Police and fire protection and ambulance and paramedic services
- Recreation programs and library services
- Operation and maintenance of museums and cultural facilities
- Maintenance of parks, parkways and open space
- Flood and storm drain protection services
- Services relating to hazardous substance clean-up

Basis for Collection. Mello-Roos and other parcel taxes are levied on real property and collected on the county property tax bills. The taxes are calculated pursuant to a formula that is established during the formation proceedings and is effectively part of the voter approval. Unlike benefit assessments, there does not have to be a nexus between benefit and the manner in which the taxes are spread. The State Constitution prohibits levying such taxes based on the value of property.

Observations Among Peer Group Cities. Special tax districts are generally formed to finance infrastructure for new development, with voter-approval provided by landowners. Some cities have a policy or practice of not allowing CFDs to be formed on residential property. When a CFD is formed, there is a general rule of thumb that the total tax bill (general and special taxes and assessments) should not exceed 2% of assessed value, although 2% is sometimes considered high for residential property.

The City of Los Angeles provides an example of a special tax levied to finance City-wide facilities. The City designed and implemented a program of new parcel tax revenues and a hybrid security structure to finance two emergency communication system programs totaling $290 million. Originally, the City wanted to go to the voters for approval of bonds to upgrade the Fire Department's communication system in the wake of a major high-rise fire. Because most of the project represented equipment and other personal property, such a project would not meet the constitutional requirement that a General Obligation bond finance only real property. The City developed a hybrid "special tax bond" for voter approval. The special tax was generally based on the amount of improvements to real property, and roughly reflected the burden the property placed on the respective public safety systems. This security was, in effect, a "synthetic" general obligation bond, authorized by ordinance under the City's charter powers and State law. The measure received over 70% voter approval.

The City of San Diego has created two Mello-Roos districts to finance improvements in connection with new development in the Miramar Ranch and Santaluz neighborhoods, and has initiated proceedings to create such districts in connection with the Liberty Station and Black Mountain Ranch developments. No such districts have yet been formed within the already developed portions of the community.

Equity & Policy Issues. New development projects effectively pay for new infrastructure through CFD taxes. The result may be that newer homes have a much higher tax bill than older homes. Property tax rates, including existing overrides, in older areas might be in the range of 1% to 1.2% of assessed value, while newer homes in CFDs (or other special tax or assessment districts) may have tax bills that total 1.5% to 2% of assessed value. Combined with typically higher assessed values, new home owners may be paying significantly more for services and infrastructure.

The existence of CFDs (or other special districts) in newer areas can create a barrier to voter approval of new bonds or tax measures, as these homeowners may feel that they are already paying their fair share and should not be paying additional taxes. Some school districts with a high concentration of CFD's, for example, have experienced great difficulty in passing General Obligation bond measures.

On the other hand, the use of special districts allows a city to tailor taxes in a way that best reflects the cost of services provided. For example, a special parcel tax can remedy one of the major equity problems with General Obligation bonds: the fact that under Proposition 13 similar properties can have widely varying assessed valuations and tax burdens.

Options to Increase. As previously noted, special tax increases require a $2/3^{rds}$ vote. A CFD or other special tax measure may be citywide or in specific zones. The creation of local special tax districts might be appropriate to older areas to bring up the quality of public facilities to that of the newer areas which have CFDs in place. A public opinion poll would help to identify popular projects that might be candidates for CFD financing.

K. Benefit Assessments

Background & Definition. An assessment is any levy or charge imposed upon real property by a public agency for a special benefit conferred upon the real property from a public improvement. Assessments can finance maintenance and capital improvements. Often, the capital improvement is financed by assessment bonds secured by annual assessment installments levied on property. The levy of assessments and issuance of bonds are completed pursuant to various statutes, such as the 1911 or 1913 Improvement Acts, the Landscape and Lighting District Act and the 1915 Bond Act.

Proposition 218 amended the State law for creating assessment districts primarily in two areas: voter-approval requirements and the nexus of the improvements to the levy. Prior to the proposition, no voter approval was required to form an assessment district. Assessment districts now require 50% approval (characterized as a majority protest procedure conducted by a ballot of property owners). The required approval is lower than the $2/3^{rds}$ approval required for Mello-Roos and other special taxes. In exchange for a lower approval threshold, assessment financing is held to a higher standard of nexus. Property owners can only be assessed for improvements that specifically benefit the property, as opposed to improvements which provide a general, area-wide benefit. Special benefit is determined by an engineer. Proposition 218 attempted to narrow the definition of special benefit, and many projects financed through assessments now also require a contribution from a city's general or other funds to finance the "public benefit" component.

The public improvements most commonly financed with assessment bonds are local streets, street lights, landscaping sidewalks, sanitary sewers, water supply and distribution facilities, flood control and drainage improvements and parking facilities.

Basis for Collection. Annual assessments are collected on the general property tax bill. The costs of maintenance or debt service are "spread" across all the properties of the district in a manner which has been determined by the assessment engineer as best measuring "benefit." Common bases for assessments include linear property frontage and property square footage.

Observations Among Peer Group Cities. Like CFDs, assessment districts are usually used to finance infrastructure for new development and are formed when the property is in the hands of developers. Improvements to older areas are more commonly financed through assessment bonds rather than special taxes due to the lower vote requirement.

San Diego has established 13 special assessment districts. As with most cities, most of these were in connection with new development projects.

Equity & Policy Issues. Much of the equity and policy issues with regard to older versus newer development which are inherent in CFDs are also relevant to assessment districts, though the equity issues are usually not as great as with assessments due to the benefit requirement.

Options to Levy an Increase and Fiscal Impact. Prior to the passage of Proposition 218, a number of cities adopted city-wide assessment districts for landscaping or street maintenance. Additional legal research would be required to determine the likelihood that a City-wide assessment district would satisfy the requirements of Proposition 218, or whether more targeted assessment districts are required. If the City were able to implement a City-wide street maintenance assessment district, the General Fund could be relieved of up to $16 million in annual expenditures for street repair and sweeping, street lighting and landscaping. Up to an additional $20 million could be used to replace gas tax transfers to those activities, freeing-up those moneys for additional road improvements in the urbanized communities. Smaller assessment districts could be established in the urbanized communities to undertake street-related improvements targeted to those communities.

L. Redevelopment Finance

Background & Definition. Since the 1950's, California cities and counties have been able to establish redevelopment agencies and create redevelopment project areas to finance certain capital improvements (as well as for other approved redevelopment purposes). A project area can only be created in areas that are found to meet the State-law requirements of "blight"; the standards for determining blight have tightened over the years.

Once a redevelopment project area is established, the assessed valuation existing at the date of adoption of the redevelopment plan is considered the "base year" for purposes of calculating and allocating the basic 1% property tax. Growth in assessed valuation due to new development, property turnovers and appreciation after that time accrues to the benefit of the redevelopment agency, and the property tax associated with that growth is generally deposited with the agency as "tax increment" revenue. Twenty percent of these funds must be dedicated to low and moderate-income housing. An increasingly significant portion of tax increment is passed-through to overlapping taxing jurisdictions. For newly created project areas, essentially 60% of the tax increment can be used for discretionary purposes.

The purposes for which redevelopment funds can be used are broad, although State law does restrict their use. They can finance most of the public infrastructure identified as required to meet current deficiencies in the urbanized communities. Tax increment funds are required by law to be spent within the redevelopment project area from which they are generated, unless they are used for housing. Tax increment revenue can be used to secure "tax allocation bonds," which do not require voter approval.

Basis for Collection. No new levies are imposed as a result of the formation of a redevelopment project area. The basic 1% property tax is simply reallocated to reflect growth in assessed valuation over time. Even with the payment of passthroughs, the collection by a city redevelopment agency is usually significantly more than the amount that would be allocated to that City as general purpose tax receipts under the AB8 formula discussed above under the discussion of Property Taxes.

Observations Among Peer Group Cities. San Diego and most other cities in the peer group have established redevelopment project areas to address certain blighted communities. The ability of these project areas to generate sufficient tax increment to finance improvements varies widely.

Options to Increase. Redevelopment is usually not a quick and sure method of financing infrastructure improvements. Redevelopment agencies have no revenue raising powers; they only collect revenues in the form of tax increment to the extent that the assessed valuation of their project area grows. In most cases, the initial investment in a project area is financed by a loan from the sponsoring city, with expectations of repayment from future growth.

The City's own experience with redevelopment illustrates the range of possible outcomes. The Centre City and Horton Plaza project areas have financed significant public investment through tax increment revenues, while other project areas such as Barrio Logan have yet to experience sufficient growth to generate more than modest revenue.

Many of the City's urbanized communities already overlap redevelopment project areas (see the map that follows), and as tax increment funds become available they might be appropriately used to finance a portion of the identified infrastructure requirements. It should be noted, however, that there is often a trade-off between using tax increment revenues to finance public improvements and using these funds to directly help foster private investment, as the latter may be a more effective generator of future tax increment growth.

The following table summarizes the increment available from the City's redevelopment project areas that overlap the communities identified as proposed Villages in the City of Villages concept. As this table shows, net increment from all these project areas only generates about $5 million a year, much of which is likely already dedicated to staff, non-bonded obligations such as development and disposition agreements, and operating expenses, or earmarked for projects. As such, these existing redevelopment project area revenues can provide minimal if any financing for the infrastructure needs that have been identified. While two other project areas, the Centre City and Horton Plaza areas managed by Centre City Development Corporation, generate more significant net revenues, these funds can only be spent for infrastructure improvements that serve those project areas; only housing set-aside funds can be expended outside the project area in which they were generated.

Table 23

Redevelopment Project Areas
Overlapping Proposed Urban Villages

Project Area	Size (Acres)	Net Increment[1]
Barrio Logan	133	$ 35,423
City Heights	1,984	1,883,764
College Community	131	409,360
College Grove	167	355,311
Linda Vista	12	80,688
Naval Training Center	504	-
North Bay	1,360	396,684
North Park	555	427,845
San Ysidro	766	773,209
Subtotal--City Redevelopment Division	5,612	4,362,284
Central Imperial	485	29,015
Gateway Center West	59	44,400
Mount Hope	210	419,240
Southcrest	301	45,800
Subtotal--Southeastern Economic Development Corp.	1,055	538,455
TOTAL	**6,667**	**$4,900,739**

[1]Net increment is total increment reduced by the 20% housing set-aside, any passthroughs to overlapping taxing jurisdictions and debt service on existing tax allocation bonds.

Source: City San Diego, Community and Economic Development Department, Redevelopment Division

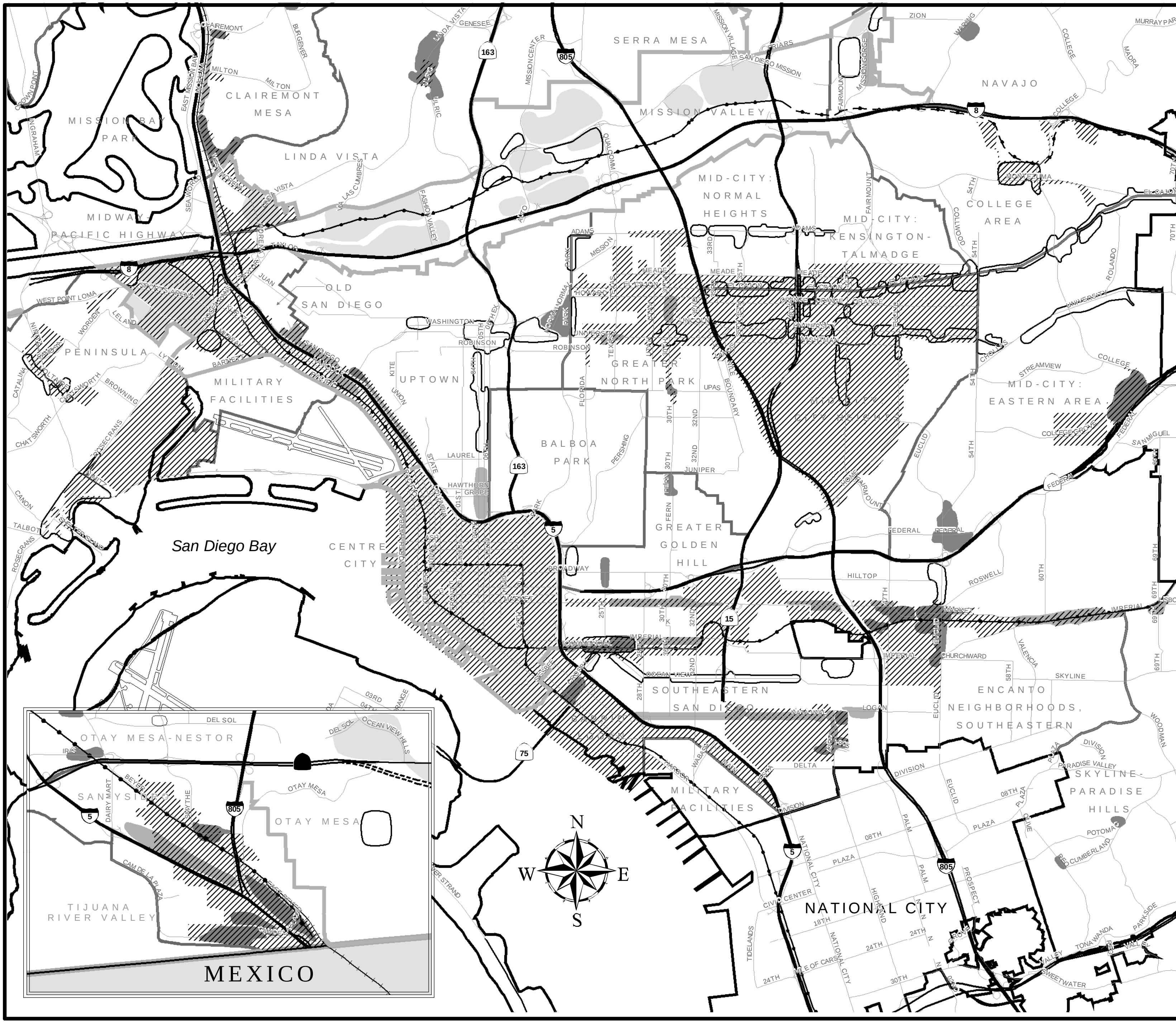
It should be noted that, as of the date of this report, the Governor is proposing reallocating approximately 4.55% of tax increment to local schools to reduce State funding requirements.

It may be appropriate for the City to establish new redevelopment project areas or expand existing project areas to include additional urbanized communities identified for capital investment within the scope of this report. The viability of a new or expanded redevelopment project area for any given neighborhood would require a case-by-case analysis of that area's specific conditions, and its likelihood of meeting the legal requirements as a project area. The creation of new project areas is a lengthy process, and typically takes several years to implement.

We do not believe that redevelopment financing should be viewed a primary tool for infrastructure in the early years of an improvement program. The generation of tax increment sufficient to finance major capital improvements will require significant growth in assessed valuation in a project area, either from new development or from rapid appreciation of property values combined with the turnover of property. The generation of such increment will take time, and may or may not occur. In addition, initial public investment is likely required to "prime the pump" and create the conditions that generate tax increment. We view redevelopment as a secondary tool that may prove valuable in the later phases of an improvement program.

Although the creation of redevelopment districts will not provide a source of funding in the initial stages, if such financing is to become available, new or expanded project areas should be considered early in the capital program. It would be wise to have these project areas in place prior to the investment in infrastructure from other, immediately available sources (such as the other mechanisms discussed throughout), as such investment will likely spur the growth in property values required to make redevelopment finance a viable tool in the future.

DRAFT City of Villages Map with City of San Diego Redevelopment Project Areas



CITY OF SAN DIEGO
PLANNING DEPARTMENT

LEGEND

Regional Center - Downtown

Downtown San Diego

Subregional Districts

Otay Mesa
Mission Valley-Morena-Grantville
Midway-Pacific Highway
Kearny Mesa
University
Sorrento Valley-Mesa

Proposed Villages

Urban Village Center*
Neighborhood Village Center*
Transit Corridor*

Existing & Future Villages & Corridors*

Urban Village Center
Neighborhod Center
Transit Corridor

See Draft Strategic Framework Element for Village Description.

Redevelopment Project Areas

Municipal Boudaries

Community Planning Areas

Freeways **Rail**
Future Freeways **Trolley**
Roads **MVE Trolley Extension**

1 inch equals 6,959 feet

4,000 0 4,000

Feet

SanGIS

tsg/3-02/SFE 4th map redevelopment.mxd

M. Infrastructure Financing Districts

In 1991, a new form of financing district was enacted into State statute. The Infrastructure Financing District combines features of redevelopment and Mello-Roos law. Similar to a redevelopment district, the property tax allocation is frozen so that incremental revenues can be dedicated to the district's purpose.

According to the statute, an Infrastructure Financing District is intended to be created in an area with substantially undeveloped land. The projects that can be undertaken by the district must be public capital facilities of community-wide significance, providing significant benefits to an area larger than the area of the district.

If at least twelve persons have been registered to vote within the territory of the proposed district, the district is formed by a majority vote of those registered voters. The district can issue bonds with a $2/3^{rds}$ vote.

It is not clear at this time if any of the urbanized communities that require the additional infrastructure to conform to the General Plan would be appropriate for this financing vehicle; but this remains an option that might play a role in an overall plan of finance.

None of the cities in our survey group have created an Infrastructure Financing District.

N. Summary of Revenue Options

The report has discussed various ways for the City to increase revenues in order to finance the capital improvements required to fully achieve existing General Plan standards in the urbanized communities. Some of these revenues would represent increases to existing sources. Others are not currently utilized by San Diego, yet are employed by many other California cities.

While this report focuses on financing for urban public facilities, those needs are also competing with other City priorities for limited municipal resources. A majority of the revenues identified are general purpose revenues, and could be used for other capital improvements as well as to finance services. It is also important that operation and maintenance needs be considered as part of the broader discussion stemming from this report.

The role of collaborative efforts in providing for both public facilities and their operation is also key to adequately addressing the long-term needs. In addition to the primary role played by the City, the Metropolitan Transit District, the school districts, the County of San Diego, federal housing funds, and State and federal transportation funds, among other sources, are all components contributing to meet urban facility needs.

The development of "Pilot Villages" will involve a prioritization of community needs as well as a review of funding opportunities among all relevant public and private entities. Demonstration projects in the form of "Pilot Villages" that incorporate City resources and draw upon the resources of other public and private entities can provide a model for success in other San Diego communities. Through a balanced plan of finance, the goals of the Strategic Framework Element of the General Plan can be achieved.

The following table summarizes the major revenue options discussed in this section of the report.

Table 24

Revenue Potential for Major Revenue Options

Tax/Fee	Revenue Generation	Assumptions
Property Tax-Overrides for Bonds	$44 million a year generated by tax rate of 0.05% (would support a bond issue of $600 million).	Based on assessed valuation of $88 billion. Bond proceeds assume 5 cent tax rate per $100 assessed valuation, and 30 year bonds at 6%. Equivalent of $101.32 for average, $202,631 assessed-value home.
Local sales tax	$42 million per 0.25%	Based on City receipts of $168 million from 1% local sales tax.
Transient Occupancy Tax	$23 million a year for a 2.5%	Based on $96.8 million at 10.5%.
Business License Tax	Additional $4.7 million from doubling of current rates of general business licences. Alternatively, an increase from $5 to $100 per employee at large firms would generate additional $23.7 million a year.	Doubling based on equivalent to current revenues. Increase of taxes on employers of 13 or more assumes 250,000 employees at such companies.
Utility Users Tax	$45 million a year for a 2.5% tax rate.	Assumes each 1% in tax generates equivalent of about $15 per capita.
Transfers from Municipal Utilities	$15.8 million per 5% "right-of-way fee" on water and sewer enterprises	Based on 1997 budgeted amounts, the last full year of this charge before its phase-out began.
Real Property Transfer Tax	$21 million at a tax rate of $2.75 per $1,000	Based on FY 2000 receipts of $5.3 million at $0.55 conforming rate, netting out sacrificed conforming receipts.
Refuse Collection Fees	Average monthly fee of $8.95	General Fund appropriation in FY 2002 Budget ($32.7 million) divided by 305,000 residences and small businesses.
Street maintenance assessment	To be determined	Currently, $15.8 million in General Funds and $19.2 million in Gas Tax Funds are appropriated to street maintenance. A significant portion of this might be financed with the creation of one or more assessment districts.
Collaborative Funding/Provision of Facilities	To be determined	Coordinated Joint Use through co-location of facilities with schools; MTDB demonstration projects supporting "Pilot Villages;" Federal, State, and other grants.

Source: Kelling, Northcross & Nobriga.

O. Case Study

To lend better clarity to the Citizen Committee in reviewing the various options, KNN was requested to prepare one or more case studies. We have selected the City of Los Angeles, since it has enacted almost all of the revenue measures discussed in this report. Table 25 puts changes in the City's revenue patterns in a historical context. Table 26 reviews the major revenue types considered in this report as used by Los Angeles.

In looking at other cities, one important factor must be highlighted: for virtually all cities discussed in this report, their revenue structures were put in place prior to constitutional initiatives limiting such activity. For example, cities which receive a large share of local property taxes had enacted high tax rates prior to Proposition 13. Cities that enacted or raised such local taxes as utility users and business license fees, or imposed assessments for landscape maintenance and street lighting, did so prior to Proposition 218. The same factors that resulted in San Diego's current, low tax burden–restraint in raising discretionary revenues–now leaves it with higher approval thresholds for instituting additional fiscal resources.

Table 25

Case Study
Los Angeles: History of Revenue Measures

Year(s)	Historical Context	City of Los Angeles Response
Before 1978	Prior to Proposition 13, cities had unlimited local taxing powers	City had a relatively high property tax levy. Property tax was dominant General Fund revenue.
1978	Proposition 13 amends State Constitution to limit property taxes	City cuts budget; reductions mitigated by State "bail-out" from surplus revenues. Los Angeles receives relatively high proportion of property taxes under State allocation formula.
1978-1982	Adjusting to Proposition 13	Increases in some fees and street lighting assessments. Modest sewer service charge imposed. Greater reliance on special revenue funds such as gas tax to offset General Fund.
1981	State Supreme Court rules in Farrel v. San Francisco that a city can levy a general tax without voter approval	Budgetary pressures lead to increases in a number of local taxes, including utility users and business license. Sewer fees increased, modest fees imposed for refuse collection and storm drainage. Transiency occupancy tax increased by 4% between 1983 and 1985.
1986	Proposition 62 seeks to require voter approval of general taxes	Because Los Angeles is a charter city, believes it is exempt from Proposition 62, which did not amend Constitution.
1986-1991	Economic expansion	Growth in revenues reduces need for additional increases in taxes. Certain fees such as refuse collection are raised. Additional 2% TOT tax to support convention center expansion.
1991-1996	Economic slowdown	Increases in business taxes (10% in FY 1990, 7.5% in 1992). New taxes imposed on parking and real estate transfers. Temporarily increased transfers from enterprise funds.
1996	Proposition 218	Puts Proposition 62 restrictions into State Constitution, requiring simple majority vote on general taxes. Also imposes new limits and requirements on assessments and certain fees even for charter cities.

Table 26

Case Study Los Angeles: Survey of Major Revenues		
Tax/Fee	**Discussion**	**Revenue Generation**
Basic Property Tax (allocation of 1%)	Prior to Proposition 13 in 1978, Los Angeles was a “high tax rate city,” with an above-average local property tax levy. As a result, it receives a relatively high proportion of the 1% property tax, at 28.9%.	18% of General Fund
Property Tax Overrides for Bonds	Beginning in 1989, Los Angeles has gone to its voters 12 times seeking 2/3rd approval of general obligation bonds; 8 of those measures have passed. Although less than half of the approved indebtedness has been issued, Los Angeles’s tax override rate is relatively high at 0.036% ($36 per a year per $100,000 assessed valuation).	Supports approx. $600 million in outstanding indebtedness.
Transient Occupancy Tax	Since 1978 (Proposition 13), the City raised hotel taxes to increase general revenues in connection with general-funded Convention Center expansion projects. All such increases have gone to the General Fund. One percent of the 14% tax rate, predating Proposition 13, is allocated to Convention Bureau.	3% of General Fund
Business License Tax	Tax rates were increased in mid-1980's and early 1990's to address budget problems. In 1999, exemptions were enacted for small and start-up businesses.	11% of General Fund
Utility Users' Tax	Tax rates were increased to 10.3% in mid-1980's to address budget problems.	16% of General Fund
Transfers from Municipal Utilities	A transfer of 5% of revenues from power and water has been in place since the 1950's. Power transfer was recently increased to 7%.	4% of General Fund
Real Property Transfer Tax	In mid-1980's, one of the first cities to levy a “non-conforming” rate.	3% of General Fund
Parcel Taxes	Received 2/3 approval for two taxes (one in 1989, the second in 1992) to support bonds for emergency communication equipment. Maximum tax rate is expected to be about $1 per 100 sq. feet of improvements.	Supported approx. $300 million in outstanding indebtedness.
Other taxes	Los Angeles levies miscellaneous other taxes, the most significant of which is a “parking occupancy tax” of 10% of the parking charge.	1.8% of General Fund
Storm Drains Fees	Fee introduced in 1980's. Grew to an average of $24 per parcel a year.	Raises about $30 million per year.
Refuse Collection Fees	Originally levied at $1.50 a month in 1983. Currently at $6.00 a month. Fee finances approximately 28% of total solid waste expenses.	Raises $48 million per year.
Benefit Assessments	Primarily for street lights. While assessment district predated Proposition 13, assessments increased to fully finance service after its passage in 1978. Rates vary; typical rate is $1.06 per year per frontage foot.	Raises $15 million per year.

PART III - DEBT FINANCING OPTIONS

6. DEBT FINANCING OPTIONS SUPPORTED BY INCREASING REVENUES

A. Developing a Balanced Plan of Finance

The previous discussion explores ways for the City to augment its revenues in order to finance the capital improvements required to bring the urbanized communities of San Diego into compliance with the City's existing General Plan. Most of the revenues identified would flow to the City's General Fund and could be used for capital improvements and any other purpose. Some of these would represent increases to existing revenue sources, others would be charges that are not currently collected by the City. Other new revenues would be restricted in their use; for example, benefit assessments would be restricted to street-related maintenance and improvements.

To optimize these revenues, the City may want to develop a long-term plan of finance which combines direct appropriations for capital improvements (commonly referred to a "pay-as-you-go" financing) with debt financing.

The following summarizes the basic forms of debt financing the City may incorporate into its plan of finance, and the respective revenue sources that would service such debt.

B. Bond Types

1. General Obligation Bonds

General Obligation bonds are backed by the full taxing power of a local government. The security for the bonds, and the source of repayment, is the power and obligation of the local government to levy property taxes at whatever rate is required to pay debt service on the bonds. In California, as in most states, such taxes are *ad valorem*, based on the value of property. As previously stated, City General Obligation bonds require a 2/3^{rds} vote.

Because General Obligation bonds are considered the strongest credit of an issuer, they carry the lowest interest rate, and therefore are the cheapest source of new capital financing. Currently, the City of San Diego has approximately $68 million in General Obligation bonds outstanding, a relatively low level of general obligation indebtedness when compared to some of its peer group cities, particularly San Francisco and Los Angeles.

2. General Fund Obligations–Lease Revenue Bonds & Certificates of Participation

Certificates of Participation or Lease Revenue Bonds are paid from annual appropriations by the City. These financing vehicles are typically not voter-approved and are not considered "debt" under the State Constitution. Consequently, new taxes are not automatically levied to make debt service payments. Instead, annual payments of principal and interest sufficient to amortize these obligations typically come from a City's General Fund. Thus, they are often referred to as "General Fund obligations" or "lease obligations" to distinguish them from "General Obligation Bonds." Lease Revenue Bonds or Certificates of Participation would be used to leverage any of the general tax options discussed above. San Diego has employed lease revenue obligations to finance a number of capital projects, most notably the convention center and the new baseball stadium. The City's debt burden from such obligations is average for cities its size.

Again, based on a variety of interest rate and other assumptions, a first-cut analysis shows that for each $100 million of improvements funded with lease obligations, $8 to $10 million in additional General Fund revenues would be required.

3. Revenue and Limited Obligation Bonds

Revenue bonds are a traditional municipal debt instrument to finance utility improvements from user fees and other enterprise revenues. State courts have concluded that such bonds do not require voter approval under the debt limits of the State Constitution, because they are repaid out of limited revenues, and not general taxes. A number of similar "limited obligation bond" instruments are common in California, including assessment, redevelopment tax allocation bonds, and Mello-Roos and other special tax-secured bonds. Some form of limited obligation bonds could be sold to leverage any new revenue source that was not a property tax override dedicated to General Obligation Bonds or a General Fund revenue.

4. Summary of Financing Vehicles

The following Table matches revenue sources to financing vehicles:

Table 27

Revenue Sources & Debt Financing Options

Revenue	Financing Vehicle
Ad valorem property tax override	General Obligation Bonds
All taxes and fees that constitute General Fund revenues:	Lease Obligations: Lease Revenue Bonds, Certificates of Participation
Property Taxes (1%)	
Business License	
Local general sales tax with majority approval & authorizing State legislation	
TOT	
Real property transfer	
Utility taxes, franchises or transfers	
Fees for refuse collection (to the extent they free-up current General Fund appropriations)	
Street maintenance assessments (to the extent they free-up current General Fund appropriations)	
New special taxes	
Local sales tax approved by $2/3^{rd}$ vote	Sales Tax Revenue Bonds
Mello-Roos taxes	Mello-Roos Bonds
Other parcel taxes	Special tax bonds
New benefit assessments	1915 Act Bonds (Assessment Bonds)
Fees for services	
Storm Drainage	Limited obligation bonds
Redevelopment or Infrastructure Finance Districts	Tax increment bonds

Source: Kelling, Northcross & Nobriga.

APPENDIX
OVERVIEW OF SELECTED OUT-OF-STATE CITIES

The Citizen Committee expressed interest in also reviewing a few out-of-state cities. They selected five western cities that are known for their strong levels of economic growth, financial stability and favorable business and commercial climates: Austin, Denver, Phoenix, Portland and Seattle.

Because municipal revenue structure is a function of state law, it is difficult to draw conclusions from this out-of-state review. None of these cities have a revenue structure as complicated as those in California. Most finance their general capital improvements with general obligation bonds.

A summary of their financial structure appears below.

AUSTIN

As with the other out-of-state peer group cities, Austin, population 42,994, has a fairly straightforward taxation and revenue structure, uncomplicated by the types of voter initiative that have distorted California cities' revenue structure through the years. Of its $398 million budget, property taxes account for 28.9% of General Fund revenues, followed by 30.7% for sales taxes and 6.0% for Franchise Fees. Austin has about $550 million outstanding in tax-supported general obligation-type debt, suggesting that this is the major means for financing general infrastructure. Net bonded debt stands at approximately $860 per capita, or 1.5% of assessed valuation, well above most California cities (by comparison, San Francisco's general obligation debt is $1,106 per capita, or 1.12% of assessed value; for next ranked Oakland, general obligation debt is $344 per capita, or .66% of assessed value).

Austin has been experiencing explosive growth and has faced the attendant problems of traffic congestion, sprawl, and re-vitalizing urban neighborhoods. However, regional efforts to address transportation issues have met with mixed success. For example, voters defeated a November 2000 initiative to construct light rail. However, the City has been successful in entering into public/ private partnerships. For example, in an effort to revitalize downtown, Austin entered into an agreement with Computer Sciences Corporation for the CSC to build a headquarters center in downtown Austin in conjunction with the building of a new city hall and public plaza.

Austin owns and operates its electric, water and wastewater systems and its own international airport. Both the electric fund and water fund are important sources of general operating revenue to the City. In 2000, the electric fund and the water fund transferred $61.2 million and $17.2 million, respectively, to the General Fund. Combined these transfers were equivalent to almost 20% of General Fund revenues.

DENVER

As of 2000, Denver had a population of 554,636, making the city almost identical in size to the city of Portland. However, the City has a much larger General Fund of $654 million, compared to Portland's $360 million. Much of this difference can be explained by Denver's status as both a city and county, by which Denver must undertake County governmental functions, as well as municipal functions.

Compared to other out-of state cities in the peer group, Denver's General Fund has a relatively small reliance on property taxes. At $58 million, these taxes comprise only about 9% of General Fund revenues, compared to 55% for the sales and use tax, which makes up by far the largest component of General Fund revenues.

The combined City and County has about $303 million in general obligation debt outstanding. With $39.2 billion in assessed valuation, the ratio of net bonded debt to AV is about 0.8%, with bonded debt per capita at $597.

PHOENIX

Phoenix has a population of 1,289,125 as of 2000, and covers an area of 477.6 square miles. It has a diversified economy, but by its own admission is over represented by the construction trades and under-represented by manufacturing.

For its general governmental functions, Phoenix's revenue sources are approximately evenly divided between city taxes, which make up 42% of governmental revenues for the 1999-00 fiscal year, and intergovernmental revenues, which make up 43%. City taxes consists of city sales and franchise taxes (32.5% of general government operating revenues), and general property taxes (9.5%). Intergovernmental revenues consist predominantly of Phoenix's share of the Arizona highway users tax (8.1%), the State sales tax (7.9%), the State income tax (9.9%), and the vehicle license tax (3.2%). State-shared revenues represent 29% of the city's general fund, and are an important source of municipal revenues under Arizona's legal structure of taxing and spending for local governments.

The City uses general obligation bonds for a variety of purposes, but minimizes the burden on the property tax base by paying debt service on general obligation bonds issued for enterprise-related projects with revenues of these respective enterprises. The Phoenix Civic Plaza receives an earmarked portion of the City's excise tax collection. The City's debt burden has remained relatively constant over the past 5 years, standing at 2.7% of assessed valuation on a direct and 5.3% on an overlapping basis. Per capita net debt is approximately $1,120.

PORTLAND

Although relatively small in population, with approximately one-half million residents, Portland has a reputation for being a well-run and model city. Like California, Oregon experienced a taxpayers' revolt that limited property tax collections. In addition, Oregon residents pay state income taxes but no sales taxes.

In Portland, the main sources of general revenues are taxes (44%), consisting mainly of property taxes, followed by licenses and permits (15%), shared intergovernmental revenues from the State and other local governments (17%), and charges for current services (14%).

According to the June 30, 2000 CAFR, funding for capital projects is primarily provided through bond financing. General Obligation bonds (approximately $116 million outstanding) were issued for water supply, renovation/facilities, parks, and emergency facilities. In addition, Portland has special assessment bonds outstanding of $22.5 million and urban renewal bonds of $105.9 million. Their largest borrowings are limited tax revenue bonds, totaling $433.7 million, which are repaid out of the City's general tax levy. These latter bonds financed a municipal arena, various capital improvements, including streetcars, and pension obligation bonds.

Net bonded debt, which consists of gross debt less all self-supporting debt is only $51.7 million. With $30.2 billion in assessed valuation, the ratio of net bonded debt to AV is only 0.17%, while net bonded debt per capita stands at a modest $100.98.

SEATTLE

In Seattle, the economy is prone to pronounced economic and cyclical fluctuations, because of the city's heavy reliance on retail sales taxes and the business and occupation taxes. Property taxes rank third in importance as a source of General Fund revenues. The three types of taxes combined make up 87% of Seattle's General Fund.

Like most cities, Seattle is attempting to identify ways to re-vitalize older neighborhoods. The City has placed a priority on upgrading and expanding libraries, with $234.6 million in capital expenditures earmarked over the next decade to fund the "Libraries for All" initiative. After a successful vote, the City issued $100 million of Unlimited Tax General Obligation Bonds in July 1999 for the "Libraries for All" project; and in October 1999, $85.5 million of Limited Tax General Obligation Bonds for various purposes. The City's net general obligation debt is a modest 1.5% of assessed valuation, while overall debt stands at 2.0%.

Seattle has five enterprise funds for which revenue bonds are issued. Seattle does not look to its utilities as a major source of revenues for general governmental functions.