

CITY COUNCIL COMMUNICATION FORM

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THROUGH: N/A

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ITEM: Fiscal Sustainability- Property Tax Scenarios.

DIRECTION
 INFORMATION
 ORDINANCE
 MOTION
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 PROCLAMATION

I. REQUEST/ISSUE & BACKGROUND INFORMATION:

Background

During the November 10, 2020 work session, staff presented City Council with multiple options to address council's long-standing goal of fiscal sustainability. Options included property tax, sales tax, lodging or accommodations tax, "lift" tax, "sin" tax, timeshare tax, paid parking, impact fees, forming a stormwater utility, and establishing new special districts.

Following discussion and deliberation, City Council directed staff to proceed with a more detailed evaluation of two options: property tax and lodging (accommodations) tax.

On December 8, 2020, City Council held another work session to discuss in more detail the two options. Staff provided research from other comparable communities along with a spreadsheet showing types of tax, tax rates, restricted uses, and diversity of revenue sources.

City Council directed staff to further investigate the possibility of a property tax ballot question in November 2021. Council also asked for more information on the possible “offset” of a property tax with a reduction or elimination of sales tax on groceries and utilities. Staff has developed several scenarios for Council’s consideration presented later in this report.

Fiscal Sustainability Goal

Following is City Council’s current Fiscal Sustainability Goal from the December 2020 retreat:

Fiscal Sustainability: Focus on diversification of city revenues; regular monitoring of city revenues and expenses; maintenance of quality of life including attainable housing; economic development, including broadband infrastructure, business retention, expansion and recruitment, and dedicated funding mechanisms.

Problem Statement

City Council has agreed to the following problem statement: *The city is too reliant upon sales tax a primary revenue source.* This overdependency on sales tax makes the city and its services subject to external factors beyond the city’s control such as tourism, weather, wildfires, special events, retail sales, airline travel, pandemics, and economic recession.

Additionally, expectations for levels of service continue to increase as the city grows, and continuing on the current track of service reductions will only lead to the inevitable – either improve our revenue picture or negatively impact the quality of life that we all enjoy.

Tackling this issue of financial instability will also be consistent with City Council’s vision statement to ensure “economic sustainability” for the long-term.

Following are more detailed evaluations of a property tax, sales tax, and various offset scenarios:

Property Tax

Pros:

- The property tax is a more stable and reliable revenue source than other taxes.
 - Property values are usually less susceptible to short-term economic fluctuations than other major revenue sources, including sales tax.
- Ensures non-resident homeowners are paying for the services they receive.
 - Many part-time residents benefit from city services but contribute only minor amounts of sales tax to cover the costs of providing these services.
- Property tax is very difficult to avoid or evade.

- Since property taxes can be secured by the property, they are difficult to evade which ensures that a broad segment of the population shares in the costs of government services.
- Property tax systems are more open and visible than those for other taxes.
 - Property owners can examine their assessments and those of nearby properties and they can appeal the assessment.
 - Property owners are provided with a statement that shows their entire liability, which makes the full magnitude of the tax obvious. This is not the case with taxes that are collected in small amounts as part of a purchase price (sales tax).

Cons:

- There is often a misunderstanding of the relationship between the actual value, assessed value, and mill levy. This can be viewed as a disadvantage when compared to fixed-rate taxes, such as sales tax.
- Due to Gallagher, commercial properties have historically paid a much higher property tax rate than residential properties (about 4x). With the recent defeat of the Gallagher Amendment, the disparity between commercial and residential property tax rates will ease over time, thereby providing some relief to commercial property owners. Tax rates may decrease but cannot be increased without a vote of the people.
- Increases the cost of housing and commercial lease rates.
 - Property taxes can result in higher monthly rental payments, adding to the cost of living. For commercial properties, the property tax is typically paid by the tenant, so a higher tax could result in higher lease rates.

One mill of property tax generates approximately **\$730,000 per year**, based on current assessed valuation.

Sales Tax

A sales tax is levied on the sale of goods and services that is usually calculated as a percentage of the purchase price and collected by the seller.

Pros:

- Shifts a portion of tax burden to visitors but everyone contributes to the "pot".
- Simplicity-other tax forms and structures can be very complex, such as income tax. Sales tax is the same for everyone and citizens are not required to keep detailed records.
- Difficult to evade-many people hide their income to avoid paying income tax, while sales tax is added to the price of the goods at the point of sale, thereby making it more difficult to evade.
- Impartial-sales taxes are impartial in nature, payable only by the consumers who buy taxable items, whether everyday needs or luxury items.

Cons:

- Uncertainty-revenue generated from sales tax is uncertain due to varying demand for products, economic fluctuations, and other external factors.
- Regressive-sales taxes are regressive in nature because it is easier for a wealthy person to pay the price no matter how high it is. At the same time, it can become a burden on a person/family with lower income.
- Raises prices-sales tax can cause an increase in the perceived price of a product for a variety of reasons.

Sales Tax Revenues:

A 1% sales tax generates approximately **\$7.0M/year** for the City of Steamboat Springs.

Property Tax and Sales Tax

Since property tax tends to be a more stable revenue source, it provides more of a "safety net" during economic downturns (see attached comparison between sales tax and property tax). It also diffuses arguments about new construction and new homeowners not paying "their fair share".

Property values are usually less susceptible to short-term economic fluctuations than sales tax. *It should be noted that sales tax on groceries and utilities are relatively stable and not as susceptible to economic downturns as sales tax on general merchandise.* These two items constitute nearly a quarter of the city's annual sales tax revenues. Eliminating sales tax on groceries and utilities would make sales tax as a revenue source even less stable. This is the primary reason most comparable cities researched tax both utilities and groceries.

In addition to City Council's goal of long-term sustainable funding, Council has determined that service level expectations from residents often exceed the city's current revenue sources, which is why lowering the sales tax rate to an amount equal to a levied property tax would be considered "revenue neutral" and would shift a sizable portion of the tax burden from visitors to residents. This "tax shift" is because non-residents (visitors and county residents that shop in Steamboat) account for about 35-40% of total sales tax revenue. While a property tax might provide more revenue stability, a revenue neutral proposal would fall short of providing the revenue needed to meet the growing demand for services.

Other Considerations

There are other considerations that City Council must evaluate when placing tax questions on the ballot. Following are some of those considerations/questions:

Should the tax be dedicated to specific government functions?

Instead of the tax going to the General Fund to support all government services the tax could be dedicated to specific functions, such as Fire or Police.

Pros:

- The specificity can be viewed favorably by the voters.
- Creates greater accountability and transparency with respect to spending allocation and priorities.
- Provides direction for spending to future City Councils.

Cons:

- Can limit options for spending for future City Councils.
- Limits flexibility for changing economic conditions.
- Policy makers and citizens may disagree on priorities and how the funds should be allocated.

Proposed Definition of City Services

City staff suggests designating a property tax to fund only "Central Governmental Services", as described below.

"Central Governmental Services":

- Police
- Fire/EMS
- Public Works (streets, engineering, airport)
- Planning
- Municipal Court
- Facilities Maintenance
- Administrative Services (financial services, city clerk, administration, human resources, procurement, IT, etc.)

"Non-Central Governmental Services":

- Transit (SST)
- Affordable housing
- Parks, Open Space, and Trails
- Recreation programs and facilities
- Community support
- Destination marketing
- Howelsen Hill operations
- Educational programs
- Economic development
- Special events
- Other

Non-central governmental services would then remain subject to the fluctuations of the sales tax revenue source and consequently the tourism sector of the local economy.

Should the tax be finite or permanent?

The property tax could sunset after a designated amount of time (i.e. 10 years) or could not have any sunset date.

Pros:

- Creates accountability in the eyes of the taxpayer, requiring policy makers to demonstrate results and justify the tax when facing expiration.
- Perceived as a definitive tax with a sunset, versus an indefinite, forever tax.
- Finite taxes are generally more popular with voters.

Cons:

- The tax could be eliminated by voters in future years, creating financial difficulty for city government if not replaced by another revenue source.
- Requires future elections which can be costly and adds uncertainty.
- Would typically require an accompanying campaign, spearheaded by a citizen's committee, which can be difficult to initiate and organize.
- Future city councils could allow the tax to expire, adversely affecting city services.

What tax rate is appropriate?

City Council needs to consider the amount of tax being requested and the level of stability that it would provide in future years. Going for small incremental tax increases has not effectively stabilized the city's revenue sources. We have adopted user fees, revised our fee schedules, and successfully passed a 2 mil property tax dedicated for Fire/EMS. If we decide to go for smaller incremental increases or for revenue neutral proposals, we will need an overall strategy to truly address the problem statement.

City Council should also consider the likelihood of generating voter support for various tax rates. A balance needs to be struck between a tax rate that meets the needs of the city but is not perceived as being too burdensome by the citizens. A tax rate proposal perceived as too high could jeopardize its chances of passing at the polls. A tax rate too low could be perceived as "not solving the problem".

II. SUMMARY AND ALTERNATIVES:

Offset Scenarios

Per City Council's request, staff has provided several scenarios for Council to consider regarding a possible offset to a property tax in the form of a reduction or elimination of sales tax on groceries and utilities.

Scenario 1 – Overall Sales Tax Reduction

Add 5 Mill Property Tax & Reduce City Sales Tax Rate by 0.5%

Revenue Neutral

Pros:

- Property tax is generally more stable and reliable than other taxes.
- Creates an equitable tax on residential property owners.
- Reduces the sales tax, which is considered a regressive tax, by a commensurate level.
- The property tax generated by new development would help pay a portion of city services.

Cons:

- Transfers a portion of tax burden from non-residents to property owners.
- Would also lose sales tax on restaurants, retail, and lodging.
- The higher property taxes could result in an increase to lease and rental rates.
- Since this is revenue neutral, it doesn't address the city's inability to meet the community's level of service expectations.

Scenario 2 – Utilities Sales Tax Reduction

Add 5 Mill Property Tax & Eliminate City Sales Tax on Utilities

Revenue positive

Pros:

- Creates an equitable tax on residential property owners.
- Reduces the sales tax, which is considered a regressive tax.
- The property tax generated by new development would pay a portion of city services.
- The property tax increase is partially offset by reduction in utility cost.
- Generates ~\$1.65M more in revenue to account for additional service expectations.

Cons:

- The higher property taxes could result in an increase to lease and rental rates.
- May not be viewed as equitable, since largest utility users would benefit the most.
- Eliminates one of the more stable sources of sales tax.
- Disincentivizes energy conservation efforts.
- Could reduce education funding by exempting utilities from sales tax.

Scenario 3- Grocery Sales Tax Reduction

Add 5.5 Mill Property Tax & Eliminate City Sales Tax on Groceries

Approximately Revenue Neutral

Pros:

- Creates an equitable tax on residential property owners.
- Reduces the sales tax, which is considered a regressive tax.
- The property tax generated by new development would pay for a portion of city services.

Cons:

- Transfers a portion of tax burden from non-residents to property owners.
- The higher property taxes could result in an increase to lease and rental rates.
- Eliminates one of the more stable sources of sales tax.
- Could reduce education funding by exempting groceries from sale tax.

Under this scenario staff estimates the financial impact to an average family of four with property in Steamboat Springs will be about a “wash”.

Property Tax Increase

$\$500,000 \times 7.15\% = \$35,750 \times .0055 = \mathbf{\$196/\text{year in property tax}}$

Sales Tax Savings

Disposable Income - $\$77,419 \times 86\% = \$66,580$

Spent on groceries - $\$66,580 \times 7.5\% = \$4,994$

Tax on groceries - $\$4,994 \times 4\% = \mathbf{\$200/\text{year}}$

Sources: Median Household Income = \$77,419 (census.gov – 2019 dollars)

Median Residential Property Actual Value = \$500,000 (includes all residential property per Routt County Assessor)

Please note food for home consumption is an estimate, therefore the exact impact is unknown.

III. STAFF RECOMMENDATION:

Staff recommends moving forward with a 5-7 mill property tax on the 2021 ballot, and that property taxes be dedicated to programs within Central Governmental Services.

Staff supports a “revenue positive” solution to sustain service level expectations and achieve Council’s long-term fiscal sustainability goal.

Staff recommends avoiding a “tax shift” from visitors and county non-residents to city property owners with a reduction of overall sales tax rate or sales tax on groceries.

Staff suggests Council review the Community Survey results in March for further guidance.

Should City Council decide to proceed with an “offset”, staff recommends Scenario 2, eliminating sales tax on utilities, although this action could undermine energy conservation efforts.

IV. FISCAL IMPACT:

One mil of property tax generates approximately **\$730,000 per year**, based on current assessed valuation.

One percent of sales tax generates approximately **\$7,000,000 per year**.

An offset of sales tax reduction or elimination will shift a portion of the local tax burden from non-residents to local property owners.

V. LEGAL ISSUES:

All scenarios will require approval by the electorate.

VI. CONFLICTS OR ENVIRONMENTAL ISSUES:

Elimination of sales tax on utilities may impact Council’s goals of environmental sustainability.

VII. CONSISTENCY WITH COUNCIL GOALS AND POLICIES:

This effort is consistent with City Council’s current fiscal sustainability goals.

ATTACHMENTS:

Attachment 1: PowerPoint Presentation.

Attachment 2: Comparable Cities Table.