



## Staff Report

**File #:** 19-290

**Version:** 1

**Date:** 6/17/2019

**Item #:** 2.a.

**TO:** Mayor and City Council

**FROM:** Steve Powers, City Manager

### **SUBJECT:**

Revenue options for the General Fund.

Ward(s): All Wards

Councilor(s): All Councilors

Neighborhood(s): All Neighborhoods

Result Area(s): Good Governance; Natural Environment Stewardship; Safe Community; Safe, Reliable and Efficient Infrastructure; Strong and Diverse Economy; Welcoming and Livable Community.

### **ISSUE:**

Shall City Council direct the City Manager to prepare two ordinances for Council's consideration to enact an operating fee and an employee-paid payroll tax to support current services in the General Fund?

### **RECOMMENDATION:**

Direct the City Manager to prepare two ordinances for Council's consideration to enact an operating fee and an employee-paid payroll tax to support current services in the General Fund.

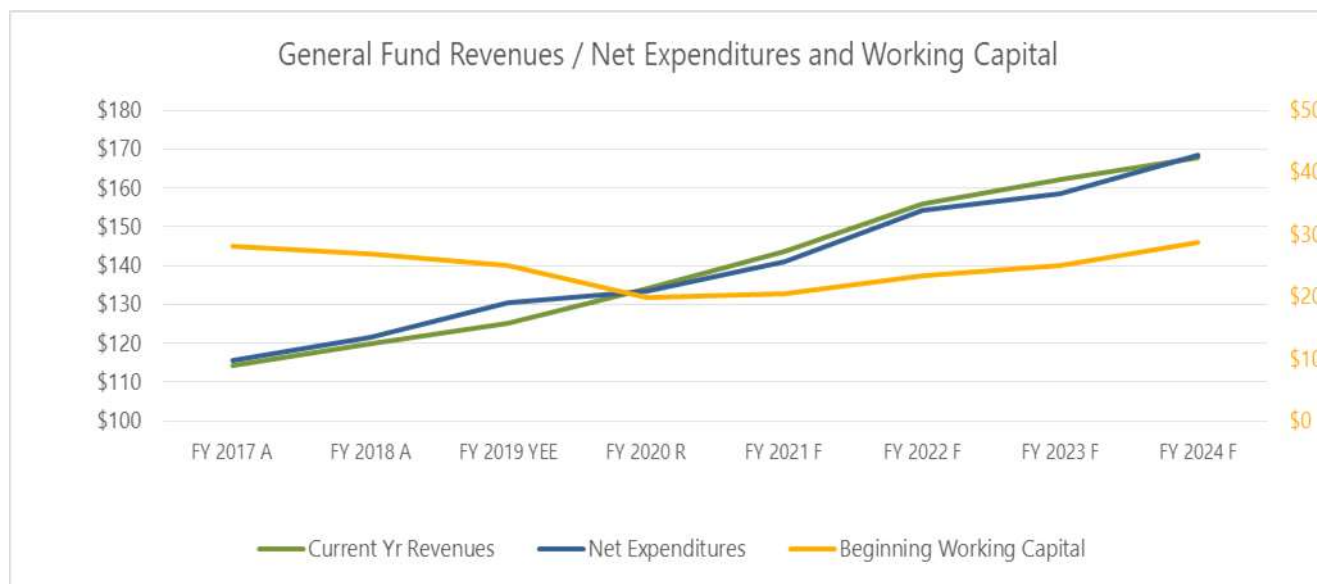
### **SUMMARY:**

There is a structural budget imbalance in the City's General Fund. Current revenues are insufficient to fund current services. The gap between revenues and expenditures worsens with the increasing demand for services as Salem's population grows and as the City's expenses increase. Without new revenue, services provided by the City will continue to deteriorate.

The City has used working capital, or our savings account, to close the gap between recurring revenues and services. Working capital is a finite revenue source. If the City maintains current budget practices, the working capital will be almost depleted by FY 2022. Without additional revenue, significant reductions to services would be required for the City to adopt a balanced FY 2022 budget in compliance with Oregon budget law.

To correct the structural budget imbalance, the City Manager recommends that City Council consider proceeding with both a City operating fee and an employee-paid payroll tax that would generate approximately \$16.2 million by FY 2022.

The recommendation combines the stabilizing, flat operating fee that provides immediate, short-term relief for the General Fund with an employee-paid payroll tax that is dynamic and more likely to keep pace with future increases in General Fund expenditures. The combination of the operating fee and payroll tax displayed below aligns revenues with expenses during the forecast period and provides funding to consider capacity increases to meet rising demand.



## FACTS AND FINDINGS:

Balancing the current FY 2019 expenses with anticipated revenues will require the use of more than \$5 million of working capital - a depletion of the General Fund's savings account. Balancing the upcoming FY 2020 City Council's Approved Budget, even with an approximate \$2.2 million reduction of General Fund expenditures, requires \$4.4 million of working capital. Attachment 1 displays current year revenues and working capital as insufficient to balance the expenditure budget by the beginning of FY 2022, or July 1, 2021.

Identifying and recommending viable funding options to fix the ongoing structural imbalance in the General Fund was the goal of City Council's Sustainable Services Revenue Task Force. During an April 15, 2019, work session with City Council, task force members delivered their recommendation of a City operating fee and employee-paid payroll tax for the General Fund and a third option of a local gas tax to support the Transportation Services Fund.

At the conclusion of the work session, City Council supported all three options for further consideration and requested additional information about the recommended revenue sources and implementation options. Information in this report is focused on the two potential revenue sources

for the General Fund.

### *City Operating Fee*

The City's General Fund supports the operation of many services valued by the community. Emergency response from police and fire; maintenance of large and small community and neighborhood parks; planning for current and future development; open access to a physical and virtual library collection and offerings of multi-generational programming at Salem Public Library and Center 50+; and active enforcement of City code to ensure Salem remains a safe and livable community represent many of the programs and services funded by the General Fund.

Staff's recommendation for Salem to join 50 other Oregon cities by providing immediate relief to the General Fund through an operating fee is intended to prevent further degradation of these services. Without additional revenue, program and staffing reductions will be required. An operating fee is a common option for cities to raise revenue. Salem currently uses this type of fee to operate, maintain, and enhance its streetlight system.

- *Enactment*

The staff recommendation of City Council implementation of an operating fee respectfully diverges from the Sustainable Services Revenue Task Force recommendation of voter referral. In every Oregon example researched by staff, existing operating fees have been enacted by city councils without referral to voters. The urgent recommendation of enactment will avoid the potential of significant reductions in services in the FY 2021 budget. If an operating fee is referred to voters and approved, it would not be in place until January 2021. With the proposed immediate adoption, revenues would begin a year earlier in January 2020.

- *Implementation Considerations*

Benefits to enacting an operating fee include the timing of implementation, an existing billing and collection structure, and the stability of the revenue source. With City Council enactment of this option, staff estimates it would require approximately six months after approval for a fee to be added to the utility billing system and collections to begin. The timing of implementation relies on the simplicity of the operating fee rate structure and use of existing data in the utility billing system. An operating fee would be a stable resource for the General Fund, with an annual growth in the number of utility accounts estimated at approximately a quarter of one percent per year.

Attachment 2 to this report demonstrates a rate structure that would generate approximately \$8.2 million per year using existing utility billing system data. This presentation of data differs from the structure discussed with the task force as it is further simplified and will be maintainable as the utility billing system undergoes required upgrades.

The revenue task force raised social equity considerations with an operating fee. The revenue task force discussed potential methods to mitigate the financial impact on lower-income residents. The staff recommendation attempts to mitigate the impact of an operating fee on residents least able to afford additional expenditures.

The most important mitigation is the amount of the fee. The recommended \$8.2 million can be reached while keeping the annual operating fee at \$120 for a single-family utility account and \$96 for each multi-family utility account.

The City has an existing program to assist low-income utility account holders. City Council recently increased funding for the program. The City will promote the program regardless of City Council's decision regarding an operating fee.

The impact of the assistance program is limited. Most multi-family dwellings in Salem are not individually metered; and the occupants of the dwellings are not the account holders. The assistance program cannot be extended to non-account holders.

With staff's recommendation, the City will generate \$4.1 million of revenue from the half year of fee collections beginning January 2020. This amount will be used to pay for the one-time, \$350,000 of programming required to prepare the utility system for the new operating fee. The General Fund will reimburse the Utility Fund for the costs of ongoing programming and data maintenance, and customer service at an amount estimated at approximately \$100,000 annually.

- *Impact to General Fund Fiscal Health - Easing the Structural Imbalance*

With \$8.2 million per year generated by the staff-recommended operating fee rate structure and the potential for revenue generation as early as January 1, 2020, the result demonstrated in Attachment 3 temporarily stabilizes the General Fund.

The operating fee revenue is joined by a positive variability of 1 percent of the original revenue forecast. The positive variability provides an allowance for a level of growth - 1 percent more - in the dozens of General Fund revenue types.

The combination of operating fee and positive revenue forecast variability allows for the temporary alignment of revenue and expenses and stalls the use of working capital to balance expenses through FY 2023, or June 30, 2023.

### *Employee-Paid Payroll Tax*

The employee-paid payroll tax is the second step in a recommended approach to address the structural imbalance in the General Fund. Stabilizing funds that can be more immediately obtained through an operating fee will slow the use of working capital to balance expenses in the General Fund, but will not stop it. Additional revenue with the potential for growth is required to keep pace with the community's service needs.

An employee-paid payroll tax would be collected through a wage deduction from employees and remitted by employers. Employees subject to the tax are employees working within city limits. The tax would be proportionate to earnings. Attachment 4 of this report demonstrates a tax rate of 0.3 percent that generates gross revenue of \$8 million in the first year of collection.

- *Enactment*

Like the City operating fee, the City Council may enact an employee-paid payroll tax through an ordinance. The task force recommended this option be referred to voters for approval.

- *Implementation*

An employee-paid payroll tax would be applied to wages earned within Salem city limits. An employee-paid payroll tax would collect revenue from those who utilize City services, but do not pay for the services through property taxes or operating fees. The Mid-Willamette Valley Council of Governments estimates that 64 percent of Salem workers live outside city limits and commute into Salem each work day. The State Employment Department's 2018 Salem Metropolitan Service Area (MSA) annual report details that 17 percent of wages earned in the MSA are derived from State of Oregon employment.

The data used to estimate the annual revenue reflects three fiscal quarters of Department of Revenue (DOR) reporting for the statewide transit tax. The DOR-reported payroll has been discounted in Attachment 4 to reflect an initial non-compliance rate of approximately 20 percent and an additional 10 percent for boundary / reporting issues. The discount rate improves to 20 percent in the second year of collection. The non-compliance rate of 20 percent is conservative, but consistent with initial experience with the transit tax as reported by a DOR representative. The DOR data has also been discounted to address possible reporting issues where businesses outside the Salem city limits may be included. The payroll figure for the DOR also includes standard exemptions used by other payroll taxes in Oregon.

Staff recommends administration of a Salem employee-paid payroll tax by the DOR. The DOR currently administers three payroll taxes in the state and is in discussion with the City of Eugene to administer a payroll tax on its behalf. DOR administration is recommended to provide a wider range of enforcement ability and capacity, established processes and systems, knowledge of businesses in Salem and relationships with those businesses, and stewardship of personal taxpayer information.

There is a cost associated with DOR administration - both one-time start-up costs estimated at \$1,000,000, as well as ongoing operational costs. The detail included with Attachment 4 estimates an annual expense of \$650,000. Collection challenges and operational costs would likely increase with added complexities, such as numerous exemptions and tax rate ranges rather than a single encompassing rate.

DOR would need legislative authority to hire staff to administer Salem's tax collection. The earliest that legislative action could be sought would be the short legislative session in spring 2020. This *earliest* timing also assumes City Council enactment through an ordinance or by voter approval through the general election in May 2020. Following legislative approval, implementation activities add another estimated 12 months before Salem could expect revenue from an employee-paid payroll tax, spring 2021.

- *Impact to General Fund Fiscal Health - Easing the Structural Imbalance*

Total wages in the Salem MSA have grown by an average of 6.7 percent over the past five

years and by an average of 4.3 percent since 2004. An employee-paid payroll tax is a revenue source that has the potential to grow with the increasing cost of General Fund services. The General Fund five-year forecast estimates 2.9 percent to 6.7 percent expenditure increases each year over the forecast period, with the larger increases aligned with the biennial escalation in PERS rates.

The combination of the operating fee and the employee-paid payroll tax aligns revenues with expenses during the forecast period and provides funding to consider capacity increases to meet rising demand. With Attachment 5, the capacity-building expenses are introduced in FY 2021 and reflect recommendations from the City's executive managers during FY 2020 budget development to support police, information technology, fire prevention, and employee recruitment services. An additional \$4 million is recommended in FY 2022 to further support services in the General Fund to meet ongoing demand in the community.

The result of the revenue options as displayed in Attachment 5 equates to an average annual household expense for a Salem resident employed within the city limits of \$321, representing \$111 for the operating fee and \$210 in estimated payroll tax for FY 2022. This display demonstrates the operating fee maintained at \$10 per month for a residential customer. The revenue generated by the employee-paid payroll tax is escalating at an estimated 5 percent each year.

### *Outreach and Information Campaign*

Similar to eliminating valued programs to ease the General Fund's structural imbalance, requesting the community's assistance with new revenue is challenging. Councils in other communities have, in many cases, tied the new revenue source to new services or enhanced levels of service. Salem's immediate need is more elemental - continuing current services. Adding to the urgency is that current service levels are inadequate meet existing demand within the community.

A robust strategy of outreach and information will need to begin immediately following City Council's revenue decision. At City Council's direction, staff will implement an outreach strategy with a combination of activities to provide the best chance of success with the collaboration, participation, and support of City Council, a diverse representation of community members in the mode of the Sustainable Services Revenue Task Force, the City's leadership team, and City co-workers who directly serve Salem residents each day.

#### **Attachments:**

1. General Fund FY 2020 - FY 2024 Re-forecast
2. Operating Fee Projections (Rate Structure)
3. General Fund Re-forecast and Operating Fee
4. Employee-Paid Payroll Tax Revenue Projections
5. General Fund Re-forecast, Both Revenue Sources and Capacity Enhancements