# City of Stockton

Council Chamber - City Hall
425 N. El Dorado Street,
Stockton CA

## Legislation Text

**File #:** 13-0549, **Version:** 1

**FUNDING PROPOSAL FOR STOCKTON'S MARSHALL PLAN ON CRIME AND RECOVERY FROM BANKRUPTCY**

RECOMMENDATION

Schedule a noticed public hearing and consideration of a tax measure on July 9, 2013, for placement before the voters at the regularly scheduled election of November 5, 2013. On July 9 it will be recommended that the Council adopt a Resolution declaring a fiscal emergency; calling for the election and approving an Ordinance establishing the specificity for a ¾ cent sales tax to be considered by the voters.

Summary

This report presents a recommendation to place a tax measure before the voters on November 5, 2013. Its purpose will be twofold. First, it will provide the necessary general fund resources to fund the City's comprehensive Marshall Plan on Crime. Second, it will provide the necessary resources to put the general fund back into a solvent position and fund the City's bankruptcy exit plan. While six of you directed me to come back with this funding plan, explained later in this report such action will require a unanimous vote of the Councilmembers present to hear the item.

As you know, bankruptcy was a necessary action to maintain health and safety services to our community. It was a necessary but interim condition for the City to develop an ultimate recovery plan. In addition to emerging from bankruptcy and becoming solvent again, the City must restore services and, most importantly, invest in the Marshall Plan on Crime. In order to meet these objectives the City needs additional tax revenues. It is important to note that while the tax measure will result in significant new revenues, it will not get the City back, revenue-wise, to where it was before the Great Recession (which was nothing short of a disaster for Stockton), nor provide the means to restore all service reductions. Moreover, even with all the restructuring savings the City is seeking and can obtain only under Chapter 9, the general fund will fall an average of $11 million short each year from being balanced just at its current level of inadequate public services. This leaves no resources to pay for the Marshall Plan, and leaves the City stuck in a service insolvent position. This is not a feasible option if the City is to achieve a sustainable budget that pays for adequate public services.

The only way to balance the general fund budget sustainably over time, restore adequate reserves, and improve public safety in the community, is to seek voter approval of additional tax revenue. The City has polled likely voters and determined that a 0.75% local sales tax, if structured so that the City could pay for improved safety services, has a good chance of garnering the needed majority vote for

a general tax measure. A unanimous vote of the members of the Council present on July 9, the date of the public hearing, is required to declare a fiscal emergency that allows such a tax on the November 5, 2013 ballot. Given the critical need to improve public safety funding, the lag time before tax proceeds come in and the lengthy process to fully implement the Marshall Plan, the City needs to pursue this tax in November, rather than wait until 2014. While the City has not concluded its bankruptcy proceeding, and may not have done so by the November 5 election, we have been declared eligible for Chapter 9 protection, and we will have a bankruptcy exit plan (Plan of Adjustment) before the judge by the election. The judge has made various rulings that minimize our concerns about voter approval of a tax before exiting bankruptcy. Furthermore, even if we received the judge's approval of a Plan of Adjustment, it would be contingent upon a voter approval of additional revenues, given the insolvent nature of the general fund from a cash and service delivery standpoint. Given the time constraints for a November ballot, the City must take action now.

*The "old" City of Stockton*

Prior to beginning the road to Chapter 9 protection, staff felt and the Council concurred, the City was not in a supportable position to ask voters for additional tax revenues. At that time, we had: (1) compensation that was above the labor market average; (2) a retiree medical insurance program that would require setting aside 30% of payroll for the next 30 years to fund; (3) outstanding lawsuits with two labor groups over past compensation impositions; (4) a growing debt burden; and, (5) no realistic potential to restore services. Any new taxes would have been consumed by the above factors. Professional polling supported the City assertions that voters would not approve new taxes without restoring services.

*The "new" City of Stockton*

However, we now have new labor agreements that have radically reduced compensation to a level that is below the labor market average for similar public agencies. We have resolved any outstanding lawsuits with the two labor groups. We have agreements with labor and retirees that will lead to the complete elimination of retiree medical insurance. The general fund's annual budget is $40 million lighter due to these reforms. We are in the process of restructuring our debt burden. We now have an omnibus plan for restoring public safety services via the Marshall Plan on Crime. We have a new management team implementing "best practices" throughout the organization. In other words, we now have something to offer the voters. We have a reformed City organization with a comprehensive plan to restore public safety services.

The recommended action will give voters a chance to restore the revenues necessary to operate the City effectively. Management and policy changes made since the disaster will allow the City to operate efficiently. There are alternatives, of course, and they are presented here. The primary alternative approach would be more service reductions and expense cutting, but I do not believe this is consistent with a viable municipality. It should be noted the suggestion that the City somehow pull out of CalPERS to solve our problems is just a variation on this theme. Losing retirement benefits that are the standard statewide would, as the prevailing evidence showed in the bankruptcy eligibility proceedings, result in a mass exodus of employees, leaving the City unable to staff at the numbers and quality needed to sustain critical public services.  Cancelling the CalPERS contract would also saddle the City with a $946 million termination payment obligation to pay for accrued liability, which the City has no ability to fund. We would have a crippled organization with a mass employee exodus and no potential for hiring replacements.  We would also gain a new “battle front” with another creditor that will consume time and resources, but to what ends?  We would have to replace CalPERS with a market competitive pension plan.  Instead, we need to continue advocating for CalPERS reform in Sacramento.

Finally, there is the nature of the tax proposal itself.  While it is currently being drafted, some basic concepts I heard from Council members and the public include: (1) it should be a general tax to address the two goals of exiting bankruptcy and the Marshall Plan; (2) if “good times” come back, there should be some measures to reduce the likelihood of monies being “wasted” on new risky adventures or excessive employee compensation; and (3) the vast majority of the new tax proceeds should be spent on restoring public safety services.  I look forward to any further goals from the Mayor or Council before the City Attorney and I submit ballot measure language for the July 9th City Council agenda.

## BACKGROUND

### Budget Impacts

Given Stockton’s heavily leveraged position, the Great Recession was nothing short of a fiscal disaster for the City. General fund revenues plunged from about $203 million to $166.5 million in one year and kept falling with a projected low of $156.8 million as of your Quarter 2 Budget Report. This revenue implosion coincided with growing costs for debt service, retiree medical coverage and compensation and benefits for employees. The City initially drew down any and all reserves, followed by deep cuts to services and reductions in any discretionary cost categories. Eventually the City was forced to declare a fiscal emergency and unilaterally implement employee compensation and benefit cuts. When these efforts all proved insufficient the City was forced to enter the AB506 mediation process and finally bankruptcy in order to address debt, labor and retiree medical cost obligations.

In other words, the City of Stockton was and remains service insolvent, meaning it is unable to pay all costs of providing services at the level and quality required for community health, safety and welfare. The budgets for fiscal years 2008-09, 2009-10 and 2010-11 combined to implement $52 million in labor compensation reductions and $38 million in staffing and service level reductions, for a total of $90 million in cuts, equivalent to a 36% reduction in the general fund budget.

Employee compensation was reduced to levels that surveys now show to be below the labor market. Depending on the labor group, compensation was cut between 12% and 34%, including the following impacts:

- Furloughs since 2008

- Salary COLAs eliminated beginning in 2008
- Employees paying their own employee retirement contribution of 7-9% of salary
- Medical plan design changes resulting in higher deductibles and co-pays, with a cap on City contribution
- Add-pays, deferred compensation, longevity, education, uniform allowances either eliminated or reduced
- Reduction in leave accruals and change in sick/vacation leave cash outs at retirement

Staffing level reductions resulted in the following general fund position cuts:

- Sworn police officers down 25% (-98 FTE)
- Non-sworn police staffing down 20% (-47 FTE)
- Fire staffing down 30% (-76 FTE)
- Non-safety staffing down 43% (-203 FTE)

In addition to 424 total general fund position cuts (31% of total), a net reduction of 42 positions in all other funds resulted in a loss of 466 positions for all funds, or 25% of the entire City workforce. Back when the budget cuts began in FY 2008-09, about 69% of general fund expenditures were allocated to labor costs, and most labor costs (86%) were for public safety. As a result, Stockton has been unable to avoid making reductions in police and fire services, despite the fact that the City ranks low in median income and high in total crime rate. The following factors highlight why the impact of these public safety reductions is more critical in Stockton than in most other California cities.

***Police Service Impacts:*** Low staffing levels have had the following significant impacts on safety for the community:

- Activation of a “condition blue” during times of peak activity where residents must use on-line or telephone reporting and depending on the type of report, the department may only respond to crimes-in-progress.
- Elimination of the School Resource Officer Program which puts the burden on school districts to provide funding for a law enforcement presence on campus. This has contributed to a rise in juvenile crime and gang membership.
- Reduction in gang and drug focused missions to only those funded with grants or outside agencies. Gang-related homicides have increased 525% in three years
- Elimination of the Narcotics Enforcement Team resulted in an increase of drug trafficking within the City and also reduces the funds received through disposition of asset forfeiture

proceeds. These proceeds are used to fund capital equipment and other one-time needs such as tactical gear, weapons and protective equipment critical to equipping sworn staff.

- Significant cutbacks to Proactive Policing Strategy have erased all progress made in the mid-2000s, returning the city to the high crime rates and overwhelming perception that the city is no longer a safe place to live, work or raise a family. A limited Proactive Policing Strategy is employed only on a case-by-case basis. However, there is a complete inability to sustain any efforts after a major mission. The officers are simply too busy responding to calls and cannot get out of their cars to interact with the community as part of any community policing effort. The detectives group has been greatly reduced, thus triaging what crimes they do investigate.
- Reduction of Community Service Officers has severely limited the ability of the Police Department to attend community meetings and respond to non-emergency accidents and calls for service including traffic control and parking enforcement (which has also reduced traffic violation revenue).

***Fire Service Impacts:*** Sworn staffing has been reduced from 225 total sworn positions at the beginning of FY 2010-11 to the current level of 181 for a total reduction of 44 positions, a reduction of nearly 32% in the past 24 months. Staffing on each piece of equipment has been reduced by one person per company, with truck companies currently staffed at four persons, and engine companies staffed with three personnel. In addition, one fire station and one engine company have closed due to the reduced staffing plan. These reductions have had the following major service impacts on the community:

- Reduction in the number of trucks assigned in the northern half of the City, which increases the response time for a second truck company, when required, on all structure fires.
- Increase in response times for engines located outside of the Fire Station One area by 1-3 minutes on average and an average increase in 5 to 7 minutes to residents and businesses within in the Fire Station One area.

Exacerbating these impacts are the following workload demands:

- The Fire Department responded to more than twice the number of fire calls of Fresno, Sacramento, or Oakland, each of which have 50,000-150,000 more in total population served and have more than twice the on-duty staffing.
- The Fire Department responded to 483 working structure fires in 2011, compared to 599 in the City of Fresno, 273 in the City of Oakland and 444 in the City of Sacramento. The City of Stockton has fewer than half the fire sworn staffing of the Cities of Fresno, Oakland, and Sacramento.
- AMR (the paramedic service provider in Stockton) exceeded its maximum emergency response time every 4 hours in the City of Stockton, compared to exceeding that response time criteria only every 70 plus hours in the cities of Lodi and Tracy.

***Public Infrastructure and City Facility Impacts:*** The City has been unable to dedicate sufficient dollars of regular and periodic maintenance of the city's public infrastructure or facilities for many years. The general fund contributed just $575,000 in FY 2012-13 to capital improvements, with no funding programmed in the FY 2012-17 Capital Improvement Program for the succeeding four years of the proposed five-year program. While not a complete list, the following illustrates the magnitude of the deferred maintenance and capital investment:

- *Vehicles*: The replacement backlog is $8.5 million, with 172 units past their useful life.
- *Trees:* About $3.1 million is needed to bring the urban forest up to an acceptable standard, with an additional $3.5 million is needed annually to provide proper maintenance.
- *Roadways*: Approximately $10 million per year is needed to maintain the City's roadways in their current condition; the City's current street maintenance program allocates only $2 million per year. The current condition can be quantified using a Pavement Condition Index (PCI) which provides an overall rating between 0 and 100 of the entire pavement in a community. The current PCI for Stockton is 66, which, while in the middle of the fair range, will degrade 2 to 3 points per year. If the network is allowed to deteriorate, repairs become more expensive as cost effective maintenance strategies are no longer feasible.
- *Parks:* About $12 million would be required to bring play areas, park furnishings, irrigation systems, buildings, courts, ball fields, and flatwork up to a standard level, able to be maintained in the future.
- *City Facilities*: The proposed program to provide critically needed improvements to City Hall includes $7 million to replace the roof, replace the HVAC system, and update interior finishes. For a complete renovation, the cost is likely double that amount ($14 million). Other City facilities would require at least $6 million to catch up on maintenance, not including about $7 million for roof repair alone.

***Library Service Impacts:*** A reduction in the Stockton-San Joaquin County Public Library system-wide operating hours by 28% and staffing levels by 50%. Customer services and literacy programs in the libraries have been reduced and there are fewer books and library materials available to the public, as well as long wait times for materials that are available. Specific reductions in library services include:

- Reduction of open hours by 48% and 11% in City and County branches, respectively.
- Reduction of Mobile Library hours by 60%.
- Reduction in books and materials by 50% over the last six years, which severely impacts the ability to acquire new format materials, e.g., digital books.
- Suspension of Homework Center Grants offered to elementary and middle school students

with low grade point averages and limited opportunities which put them at educational risk.

***Community Program Service Impacts:*** As a result of the elimination of 15 full-time positions and an 80% reduction in part-time hours, Recreation programs have experienced significant service reductions including:

- Partial Closure of the McKinley Community Center in 2009. Most of the recreation programs were moved to other community centers, so residents have to travel further to participate in these recreation opportunities.
- Reduction in operating hours at all other community centers of 20%.
- Fewer recreational classes.
- Decrease in operational hours at the Children's Museum, Pixie Woods amusement park, and Oak Park Senior Center.
- Consolidation of After School Program (ASP) sites resulting in reduced programs for at-risk youth.

***Internal Support Needs:*** What is invisible to most citizens is the degradation of programs necessary to support all services, including public safety.

- The internal self-insurance funds were gradually drained of their resources to the point our workers compensation fund has a negative $43 million fund balance. Our liability fund has a negative $5 million fund balance.

- Our technology systems have not been replaced in a timely fashion. For example, our financial system is 21 years old, with an estimated replacement cost of $10 million.

This level of cuts, while unheard of among California cities, was still not enough to avoid insolvency. To be truly sustainable, many of these prior cuts will have to be reinstated at some point. As emphasized in its AB506 restructuring proposal, the City must remain viable as a municipality by achieving a sustainable fiscal position and regain service solvency. Chapter 9 was the only possible option for creating a viable foundation to meet these goals. However, while the restructuring savings achievable only under Chapter 9 are vitally necessary, they are insufficient, even with all of the prior City budget cuts, to resolve the City's financial woes, without additional resources.

<u>Bankruptcy Process</u>

The City has experienced massive budget deficits for the past several years, owing to the economic collapse of the Central Valley economy during the Great Recession, an excessive debt burden amassed by the City since 2003, the granting of unsustainable labor contracts and retiree medical benefits, past financial miscalculations and the elimination by the state of redevelopment agencies. Even after implementing $90 million of extraordinary service reductions, privatization measures and huge employee compensation reductions, the FY 2012-13 Budget faced a shortfall of $26 million.

In February 2012 the City implemented budget corrections to retain a balanced budget through June 30, and started the AB506 mediation process in an effort to avoid bankruptcy. During the AB506 process some participants worked very hard to understand the City's financial status and many tried to reach agreements that would improve the City's unsustainable financial position. The City was required by its Charter and by state law to adopt a balanced budget by June 30, and so on June 26, 2012 the City closed its remaining deficit by approving the 2012-13 Pendency Plan. The Pendency Plan suspended debt payments, phased out all retiree medical benefits over one year, continued reductions of pay and benefits imposed under previous Declarations of Fiscal Emergency and reduced compensation components that exceeded those in the City's labor market to close the $26 million gap.

The City's eligibility for bankruptcy was immediately challenged by a consortium of financial debt creditors consisting of Assured Guaranty, National Public Finance Guaranty and Franklin Funds, collectively known as the Capital Markets Creditors. While the eligibility issue was being litigated, the City's bankruptcy Judge, the Honorable Christopher Klein, ordered the City to mediate obligations in dispute and appointed Judge Elizabeth Perris to act as our Mediation Judge.

In mediation with Judge Perris, the hard work and good faith efforts of the City's labor team and labor groups begun in AB506 continued, resulting in six amended labor agreements by July 24, 2012. Another two agreements with labor were reached on August 28, 2012. Those agreements resulted in waiving claims to prior imposed pay and benefit reductions, achieving approximately 85% of the original AB506 ask with respect to future savings, and avoided further litigation costs between the labor groups and the City.

In March 2013 the City was able to negotiate a tentative agreement with Ambac relating to the 2003 Certificates of Participation debt obligation. This agreement was finalized in April 2013.

As mentioned above, the Capital Markets Creditors challenged the City's eligibility for bankruptcy, which consumed months of effort. This legal process culminated in Judge Klein's ruling on April 1, 2013 granting Stockton access to bankruptcy protection, in which he ruled that Stockton officials and financial experts had demonstrated the City was indeed insolvent on June 28, 2012, that it needed the muscle of Chapter 9 to maintain its viability and that the City had acted in good faith. Through this bankruptcy case the judge has made another important decision. He confirmed that the judiciary cannot tell the City Council how to run itself and spend its money. We believe this is an important decision that greatly reduces the risk of seeking more tax revenues before the judge actually rules on a bankruptcy Plan of Adjustment. Since then the City has continued to be engaged in mediation efforts with retirees, bond creditors and other claimants.

In June 2013 the City was able to reach a tentative agreement with one of the largest creditors in the bankruptcy, the Association of Retired Employees of the City of Stockton (approximately 1,100 retired individuals who had been promised lifetime medical insurance coverage at no cost for the retiree and a spouse). This agreement should be finalized in July 2013.

We also have a tentative agreement with the Marina Towers group.

We have continued to mediate with the remaining creditors which consist of

- The Capital Markets Creditors (Assured, NPFG and Franklin), which have five secured and one unsecured debt obligation between them
- Sports teams (the Stockton Thunder and Ports), which are both subsidized by the City
- Two legal settlements known as the Price and Jarvis matters
- The State of California Department of Boating and Waterways relative to loan funding for the Stockton Marina

Our schedule calls for submittal of a plan of adjustment in the third Quarter of 2013 which will set the stage for a final resolution via a litigated confirmation process. Once the plan is approved it becomes the basis for exiting bankruptcy. However, I do not think Stockton's recovery of much needed services should be held hostage to an unknown court schedule and creditor actions.

Bankruptcy presents a special challenge in the context of voter consideration of a new general tax measure. It introduces some uncertainty but because of the previously mentioned judge's decision we think it is a manageable risk. As I said earlier, neither the Court nor the creditors override the discretion of the elected City Council to determine the requirements for the municipal corporation and to make decisions about the allocation of the resources available. Stockton has been completely honest and transparent about the need to obtain additional general fund revenues for the purposes of addressing the critical public safety needs which exist and addressing the other critical needs of the City.  We have shared this fact with creditors.

In addition, such revenues are necessary to allow the City to meet the requirements of the restructuring proposals which have been made in the AB506 process and bankruptcy mediation. Any plan of adjustment approved by the judge will be contingent on voter approval, anyways.  Thus, voter approval of more resources makes for a stronger plan from the City.  The Court has rebuffed efforts by the creditors to submit alternative spending proposals which are implicitly anchored in alternative public policy determinations, in order to substitute them for the considered determinations actually made by the elected City Council. Our proposal to submit a general tax measure for consideration is shaped by the fact that such a tax best meets the needs of the City and its citizens, and the settled law under Chapter 9.  The City retains its ability to make the determinations about resource allocation which are fundamental to elected representative governance.

**DEVELOPMENT OF MARSHALL PLAN TO IMPROVE PUBLIC SAFETY**

In April 2012 the City initiated development of a Marshall Plan to reduce homicides and violence. This is a multi-generational chronic problem that has only gotten worse with a hard economy and reduced police staffing levels, as illustrated by the following points:

- The City of Stockton has the second highest total crime rate per capita for any city with a population of 100,000 or greater in California.
- While violent crime rates dropped 5.5% nationwide in 2010, they were up in Stockton, which ranked 10th in the entire U.S. with 13.81 violent crimes per 1,000 residents.
- Despite this high service demand, budget cuts have reduced sworn police staffing from 1.52 per 1,000 residents in 2005 to 1.17 currently (before addition of 17 grant-funded positions), which is the lowest ratio for cities over 250,000 population, notwithstanding our high crime rate.
- The City has a lower level of sworn police staffing than has been recommended by industry standards or which is observed in other similar service settings. The 2006 Braga study recommended sworn officer staffing levels at 2.0 per 1,000 residents, which even with the pending addition of 17 grant-funded officers, would require the addition of 240 police officers at a total annual cost (including equipment and support costs) of $50 million when fully implemented in FY 2020-21.

As the Marshall Plan report endorsed by the City Council stated, violence is a learned and contagious behavior perpetrated by a relatively small number of individuals. There is no single solution to violence, and the Marshall Plan has engaged key stakeholders in the community and criminal justice system to develop workable strategies. This will require a significant financial commitment by the City in excess of $20 million annually.

With five of the six City Council Town Hall Meetings concluded, the feedback has been cautiously supportive. The most common concern revolves around past Council decisions in the areas of employee compensation, retiree health and new business ventures (debt and operating subsidies). Other feedback on the Marshall Plan was consistent with what you heard at your Council meeting, e.g. we need additional employment opportunities and can we really impact the balance of the criminal justice system. On the topic of mistrust due to previous decisions, I will be submitting a tax proposal on July 9 that responds to these concerns.

Table 1 shows the projected cost by major element of the Marshall Plan, including additional sworn officers added over a three-year period, and staffing level relative to population. Officer costs include supervisory positions needed for an expanded force, vehicles, equipment and overtime. Salaries and benefits include projected future cost increases. Support positions include additional crime analysts and records assistants needed to service the increased number of officers and a small Office of Violence Reduction, whose sole focus will be to ensure the sustainability of the Marshall Plan goals. Operation Ceasefire (currently grant-funded) would be continued and Operation Peacekeepers would be expanded. Neighborhood improvement programs include expanded code enforcement and neighborhood “blitz” teams.

**Table 1**

**Projected Marshall Plan Cost Over General Fund Forecast**

| ($ in Millions) | 11-12 | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 |
|---|---|---|---|---|---|---|---|---|---|---|
| New Officers | - | - | - | 40 | 40 | 40 | - | - | - | - |
| Total Sworn FTE | 345 | 362 | 362 | 402 | 442 | 482 | 482 | 482 | 482 | 482 |
| Est City Pop (000) | 295.0 | 296.5 | 297.9 | 299.4 | 300.9 | 302.4 | 303.9 | 305.5 | 307.0 | 308.5 |
| Sworn FTE/1000 Pop | 1.17 | 1.22 | 1.22 | 1.34 | 1.47 | 1.59 | 1.59 | 1.58 | 1.57 | 1.56 |
| Costs: | | | | | | | | | | |
| New Officers | - | - | - | $6.64 | $12.72 | $19.37 | $19.98 | $21.51 | $23.10 | $24.44 |
| Support Staff | - | - | - | 0.52 | 0.60 | 0.75 | 0.76 | 0.78 | 0.79 | 0.81 |
| Violence Reduction Offi | - | - | - | 0.25 | 0.26 | 0.26 | 0.27 | 0.27 | 0.28 | 0.28 |
| Ceasefire/Peacekeepers | - | - | - | 0.61 | 0.63 | 0.64 | 0.65 | 0.66 | 0.68 | 0.69 |
| Neighborhood Imprvmt | - | - | - | 1.31 | 0.71 | 0.52 | 0.53 | 0.54 | 0.55 | 0.56 |
| Total Cost | - | - | - | 9.33 | 14.91 | 21.53 | 22.18 | 23.76 | 25.40 | 26.78 |

## TRANSACTIONS AND USE TAX TO FUND THE MARSHALL PLAN AND OTHER CRITICAL NEEDS

In fall 2012 the City polled likely voters to assess attitudes toward a potential ballot measure to enact an additional local sales tax rate. In January 2013, Mayor Silva proposed a special tax initiative devoted to public safety. On April 2 the City Council discussed that proposal and concerns about harming our bankruptcy efforts and exacerbating the general fund’s financial condition. The Council directed me to facilitate town hall meetings on the Marshall Plan and return with a funding proposal for it. Following discussions with business leaders the City was urged to bring forward a general tax proposal that would both balance the general fund budget and fund the Marshall Plan for improved public safety, which will be the measure before you on July 9.

A local sales tax, technically known as a transactions and use tax, requires voter approval. Normally, a general tax requiring majority voter approval must appear on a municipal ballot along with council elections. The next Stockton municipal ballot does not occur until June 2014, which is too long to wait given the City’s dire financial condition and the need to begin recovery. However, pursuant to Section 2(b) of Article XIIIC of the California Constitution, the City Council may, upon declaration of a fiscal emergency by a unanimous vote of the members of the Council present at the public hearing, submit the proposed transactions and use tax as a special election, in this case consolidating it with the county’s uniform district election of November 5, 2013.

As shown by the magnitude of the budget cuts already enacted, the City is not in a position to absorb any more cuts. The only alternative to further reducing public services is additional tax revenue. The California Constitution requires voter approval for new taxes, and a number of other California cities have taken tax proposals to their residents in recent years. As reported by the California Local Government Finance Almanac, on the November 2012 statewide ballot a total of 48 of 60 city general tax (majority vote) measures were passed (80% approval rate), while 5 of 15 city special tax (two-thirds vote) measures passed (33.3% approval rate). As to local transactions and use tax measures specifically, 31 of 33 city general tax measures passed (93.9% approval rate) versus 1 of 3 city special tax measures (33.3% approval rate). This recent level of success of general taxes is significantly higher than the outcome for such measures since 1995, as shown in Table 2.

**Table 2**

**City Transaction and Use Tax Measures (1995-2013)**

| | Passed | Failed | Total | % Passed |
|---|---|---|---|---|
| General Tax | 115 | 54 | 169 | 68.0% |
| Special Tax | 27 | 28 | 55 | 49.1% |
| Total | 142 | 82 | 224 | 63.4% |

Table 3 breaks down the city transaction and use taxes currently in effect by level of tax rate. Section 7285.9 of the Revenue and Taxation Code provides that a city may levy a transactions and use tax in multiples of 0.125% provided all overlapping tax rates do not exceed 2.00%. No city in California has ever levied greater than a combined 1.00% local rate. There are 10 other cities that have two transaction and use tax rates, as would Stockton if this measure is enacted. Stockton has the 0.25% Measure W rate now, and adding 0.75% would go to the maximum any other city is charging. For competitive reasons, it would not be prudent to go in excess of this amount.

**Table 3**

**Transaction and Use Taxes Currently in Effect**

| Rate | General Tax | Special Tax | Total |
|---|---|---|---|
| 0.250% | 14 | 6 | 20 |
| 0.375% | 1 | 0 | 1 |
| 0.500% | 59 | 17 | 76 |
| 0.750% | 6 | 2 | 8 |
| 1.000% | 20 | 0 | 20 |
| City Total | 100 | 25 | 125 |
| Other Agencies | | | 39 |
| Grand Total | | | 164 |

The City's poll of likely voters last fall showed an initial 71% support for a 0.75% general sales tax to "improve and maintain essential City services, which may include a community-wide plan, developed by local leaders and criminal justice experts, with strategies to reduce crime in Stockton, including expanding the police force, improving 9-1-1 emergency response services, increasing anti-gang and crime prevention programs, and other general services such as street repair, libraries and parks." After hearing both pro and con arguments the level of support moved to 68%. Alternatively, only 21% supported a measure whose proceeds "would primarily provide funding to pay existing debt holders, employee compensation and benefits, and city paid retiree medical benefits, but would not improve existing services or restore services that have previously been cut."

## PROPOSED TAX

The proposed ballot measure language is currently being drafted and will be available during the normal publication of the July 9 City Council Agenda. The proposed new tax would be a 0.75% transaction and use tax (sales tax) that as a general tax requires a majority voter to enact. It is expected to produce approximately $28 million in its first full year and grow at a rate of about 3.5% annually. Over a ten-year period approximately $219 million would be used to fund the Marshall Plan, and approximately $112 million would be used to fund the City's exit from bankruptcy. With a three-year phase-in to full additional police staffing, and the need to eliminate the remaining general fund shortfall and re-establish reserves at the outset, in the initial years a larger proportion of funds would be devoted to the Bankruptcy Recovery Plan. By year four and thereafter the added public safety services would require 70-75% of the additional tax revenues; over time the ratio is projected to be approximately 66% for Marshall Plan expenses and 34% for the Bankruptcy Recovery Plan and other services. Given the well documented poor practices of the past, I will be recommending very unique accountability measures in the tax ordinance that ameliorate the risks going forward.

Table 4 shows the recent and future changes in total sales tax rate applicable in Stockton, assuming implementation of a 0.75% transactions and use tax.

**Table 4**

**Change in Total Sales Tax Rate in Stockton**

| Rate | Date | Action |
|---|---|---|
| 8.00% | 1/1/12 | Before Prop 30 |
| 8.25% | 1/1/13 | After Prop 30 |
| 9.00% | 4/1/14 | Approval of New Tax |
| 8.75% | 1/1/16 | Prop 30 Expires |

Table 5 compares the current and proposed level of total sales tax rate in Stockton to the current total rates applicable in surrounding jurisdictions.

**Table 5**

**Surrounding Jurisdiction Tax Rates**

| | |
|---|---|
| 9.000% | Lathrop |
| 9.000% | Livermore |
| 9.000% | Stockton (proposed) |
| 8.625% | Fairfield |
| 8.500% | Manteca |
| 8.500% | Sacramento |
| 8.500% | Tracy |
| 8.250% | Stockton (current) |
| 8.000% | Elk Grove |
| 8.000% | Lodi |
| 7.625% | Modesto |

## FINANCIAL SUMMARY

### Revenue Generating Capacity

If the tax is approved on the November 5, 2013 ballot, it will take effect on April 1, 2014, and the City will accrue one quarter's worth of revenue (approximately $6.8 million) for FY 2013-14, with full year collection starting in FY 2014-15 at approximately $28 million annually.

A transaction and use tax may raise less (or more) than the equivalent rate of sales tax due to special provisions affecting vehicle sales and other transactions that are based on residency of the buyer, rather than location of the sale. HdL Companies, a sales tax consultant, summarizes the revenue effect as follows: "In projecting revenues, cities who serve a regional market for vehicles or merchandise to be delivered elsewhere such as contractor materials or industrial equipment and goods, will find that their transactions and use tax is proportionally lower than their sales tax revenues. A city whose residents and businesses must shop outside the city for vehicles and business and construction related goods, will find that their transactions and use tax receipts are proportionally higher than their sales tax revenues."

As a regional market, a transactions and use tax in Stockton would raise proportionately less than its sales tax revenue, which is the experience with the City's current 0.25% tax for public safety (Measure W), which generates around 94.6% of a comparable rate of sales tax. The revenue projected from the proposed 0.75% tax is based on the revenue-generating capacity of Measure W (i.e., three times the revenue collected from Measure W's 0.25% tax rate).

Table 6 shows the projected use of the new tax proceeds between balancing the general fund budget (Bankruptcy Recovery Plan) and improving public safety services (Marshall Plan). Initially more proceeds are devoted to bankruptcy recovery, and then as Marshall Plan costs are fully phased in, more proceeds will be used to fund this improvement in public safety services. Over a ten-year period, it is estimated that safety services will consume approximately 66% of total tax proceeds, and balancing the general fund budget and emerging from bankruptcy will require approximately 34% of total tax proceeds.

**Table 6**

**Projected Use of New Tax Revenue Over Ten Year Period**

| ($ in Millions) | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 | 21-22 | 22-23 | 23-24 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **New Tax Revenue** | $6.9 | $28.4 | $29.4 | $30.4 | $31.5 | $32.7 | $33.8 | $35.0 | $36.2 | $37.5 | $29.1 |
| **Marshall Plan** | - | $9.3 | $14.9 | $21.5 | $22.2 | $23.8 | $25.4 | $26.8 | $27.0 | $27.5 | $21.0 |
| % Annual Use of Tax | 0% | 33% | 51% | 71% | 70% | 73% | 75% | 77% | 75% | 73% | 72% |
| % Cumulative Use | 0% | 26% | 37% | 48% | 54% | 58% | 61% | 63% | 65% | 66% | 66% |
| **Bankrupcy Recovery** | $6.9 | $19.1 | $14.5 | $8.9 | $9.4 | $8.9 | $8.4 | $8.2 | $9.2 | $10.0 | $8.1 |
| % Annual Use of Tax | 100% | 67% | 49% | 29% | 30% | 27% | 25% | 23% | 25% | 27% | 28% |
| % Cumulative Use | 100% | 74% | 63% | 52% | 46% | 42% | 39% | 37% | 35% | 34% | 34% |

General Fund Forecast

Unless this tax is approved by the voters, the City will continue to run shortfalls. Tables 7, 8 and 9 on the following pages are based on 2011-12 financial statements pending audit and 2012-13 projections as of your Quarter 2 Budget Report. Table 7 shows the annual general fund shortfall and ending fund balance after Chapter 9 restructuring savings, but without both the Marshall Plan and new tax revenue, over the City's 10-year forecast period; the annual shortfall ranges from $8.6 million in FY 2013-14 to $79.1 million by FY 2020-21, and deficits begin in FY 2014-15.

**Table 7**

**Summary Forecast After Chapter 9 But No Marshall Plan and No New Tax**

| ($ in Millions) | 11-12 | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Revenue | $160.3 | $156.8 | $159.5 | $161.5 | $165.5 | $171.1 | $176.0 | $181.1 | $186.3 | $190.1 |
| Total Expenditures | 166.8 | 156.9 | 159.5 | 170.1 | 177.0 | 179.1 | 186.0 | 192.9 | 200.7 | 204.9 |
| Net Annual | **(6.6)** | **(0.1)** | **-** | **(8.6)** | **(11.5)** | **(8.0)** | **(10.0)** | **(11.8)** | **(14.4)** | **(14.8)** |
| Beginning Balance | 6.6 | 0.1 | - | - | (8.6) | (20.1) | (28.1) | (38.1) | (49.9) | (64.3) |
| Ending Balance | **0.1** | **0.0** | **-** | **(8.6)** | **(20.1)** | **(28.1)** | **(38.1)** | **(49.9)** | **(64.3)** | **(79.1)** |
| Bal as % of Total Exp | 0.0% | 0.0% | 0.0% | -5.0% | -11.3% | -15.7% | -20.5% | -25.9% | -32.0% | -38.6% |

Table 8 shows the impact of adding the cost of the Marshall Plan to Chapter 9 savings, but without the new tax, which results in annual shortfalls $17.9 in FY 2014-15 to $223.0 million by FY 2020-21; the ending fund balance falls dramatically farther into deficit.

**Table 8**

**Summary Forecast After Chapter 9 With Marshall Plan But No New Tax**

| ($ in Millions) | 11-12 | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Revenue | $160.3 | $156.8 | $159.5 | $161.5 | $165.5 | $171.1 | $176.0 | $181.1 | $186.3 | $190.1 |
| Total Expenditures | 166.8 | 156.9 | 159.5 | 179.4 | 191.9 | 200.6 | 208.2 | 216.7 | 226.1 | 231.7 |
| Net Annual | **(6.6)** | **(0.1)** | **-** | **(17.9)** | **(26.4)** | **(29.5)** | **(32.2)** | **(35.6)** | **(39.8)** | **(41.6** |
| Beginning Balance | 6.6 | 0.1 | - | - | (17.9) | (44.3) | (73.8) | (106.0) | (141.6) | (181.4 |
| Ending Balance | **0.1** | **0.0** | **-** | **(17.9)** | **(44.3)** | **(73.8)** | **(106.0)** | **(141.6)** | **(181.4)** | **(223.0** |
| Bal as % of Total Exp | 0.0% | 0.0% | 0.0% | -10.0% | -23.1% | -36.8% | -50.9% | -65.4% | -80.2% | -96.2% |

Table 9 shows the impact of adding a 0.75% local sales tax, as well as the cost of the Marshall Plan and Chapter 9 savings, which results in a balanced budget throughout the forecast period, with reserve levels averaging approximately 8% for the period of FY 2013-14 through 2020-21. While the balance declines in the latter years of the City's 10-year forecast, beyond that forecast period the rate of decline slows in the mid-2020's and the general fund is projected to avoid going into deficit due largely to the expected long-term trend of pension costs.

CalPERS rates are projected to increase significantly through 2020 due to recently adopted rate smoothing and unfunded liability amortization policies, an expected further reduction in the discount rate (actuarial investment return), and other changes. However, the Public Employee Pension Reform Act (PEPRA) grants lower benefits to new employees, so savings will accrue over time with turnover in the workforce. Also, under the smoothing and amortization changes the City pays more in the near-term, but less later on. As a consequence of this restructuring, pension contribution rates as a percent of payroll will level off and then begin to decline, resulting in projected annual surpluses and increasing fund balance by the late 2020's. The City is projecting this rate of decline at a much more conservative rate than that discussed by CalPERS staff.

**Table 9**

| Summary Forecast After Chapter 9 With Both Marshall Plan and New Tax | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| ($ in Millions) | 11-12 | 12-13 | 13-14 | 14-15 | 15-16 | 16-17 | 17-18 | 18-19 | 19-20 | 20-21 |
| Total Revenue | $160.3 | $156.8 | $166.4 | $190.1 | $195.3 | $202.0 | $208.0 | $214.2 | $220.5 | $225.3 |
| Total Expenditures | 166.8 | 156.9 | 159.5 | 179.4 | 191.9 | 200.6 | 208.2 | 216.7 | 226.1 | 231.7 |
| Net Annual | **(6.6)** | **(0.1)** | **6.9** | **10.8** | **3.4** | **1.3** | **(0.2)** | **(2.5)** | **(5.6)** | **(6.3)** |
| Beginning Balance | 6.6 | 0.1 | - | 6.9 | 17.6 | 21.0 | 22.3 | 22.2 | 19.7 | 14.0 |
| Ending Balance | **0.1** | **0.0** | **6.9** | **17.6** | **21.0** | **22.3** | **22.2** | **19.7** | **14.0** | **7.7** |
| Bal as % of Total Exp | 0.0% | 0.0% | 4.3% | 9.8% | 11.0% | 11.1% | 10.6% | 9.1% | 6.2% | 3.3% |

## ALTERNATIVE TO NEW TAX REVENUE IS ADDITIONAL BUDGET CUTS

The alternative to enacting a new tax is to make additional reductions in service levels. Otherwise, the City cannot present a viable Plan of Adjustment for exiting bankruptcy.

- Balancing the general fund budget without both the Marshall Plan and new tax would require a 7% reduction in the total general fund expenditures remaining after Chapter 9 restructuring. This would generate approximately $11 million in savings when fully implemented in FY 2014-15 (half that amount in FY 2013-14 by the time cuts could be started), with growth in the value of the avoided costs over time.

- Balancing the general fund budget with the Marshall Plan but no new tax would require a 15% reduction in total general fund expenditures remaining after Chapter 9 restructuring, which would generate approximately $26 million in savings when fully implemented in FY 2014-15 (half that amount in FY 2013-14 by the time cuts could be started), with growth in the value of the avoided costs over time.

Additional budget cuts in this range of $11-26 million, especially if the weight of cuts were borne by non-safety services, would seriously undermine the long-term viability of Stockton. Even if the Marshall Plan is adopted, the City's viability is not determined by public safety services alone. As important as is public safety, citizens and businesses don't move to or stay in a city solely on the basis of police services. Parks, libraries, recreation and/or entertainment opportunities, schools, employment opportunities, reputation, sense of safety, predictability and lifestyle are all part of a city's long-term viability.

Table 10 shows the type of budget cuts that might be required in the absence of new tax revenue. These items were on a contingent cut list from the FY 2011-12 budget and total $22 million. This is more than enough to balance the general fund budget without the Marshall Plan, or just enough to balance the budget while funding about 75% of the Marshall Plan.

**Table 10**

**Example of $22 Million in Additional Cuts That Might Be Required in the Absense
New Tax Revenue Based on Contingent Departmental Cut List from 2011-12 Budget (**

| | | | |
|---|---|---|---|
| Non-Safety: | | Fire: | |
| Admin, CC, Non-Dept-cut 5 FTE | $354 | Truck 2-cut 1 FF/sh | $405 |
| Admin Svc-cut 9 FTE | 442 | Truck 3-cut 1 FF/sh | 405 |
| Auditor-15% reduction | 65 | Truck 7-cut 1 FF/sh | 405 |
| City Atty-cut 1 advisory atty | 126 | Close Engine 6 | 1,351 |
| City Clerk-cut 1 FTE | 79 | Close Engine 11 | 1,351 |
| Econ Dev-15% reduction | 103 | Close Engine 14 | 1,351 |
| Ent Venue-reduce maint/other | 244 | Close Truck 3 | 1,351 |
| Ent Venue-close ballpark | 366 | Other savings | 65 |
| Develop Svcs-elim GF subsidy | 1,000 | Reduced Fire Dist reimburse | (662) |
| Golf-close Van Buskirk | 250 | Subtotal Fire Dept | 6,022 |
| CIP-cut GF funding | 575 | | |
| HR-reduce training | 80 | Police: | |
| HR-cut 3 FTE | 184 | Cut 30 CSOs (net of rev loss) | 1,751 |
| Library-cut 7 FTE/31% fewer hrs | 500 | Records staff cut 3 FTE | 199 |
| Library-cut landscaping 50% | 10 | Telecommunication cut 3 FTE | 267 |
| Rec-cut 3 FT/3 PT | 242 | Investig/traffic/other cut 14 F | 1,139 |
| Rec-after school reduction | 48 | Traffic section cut 12 FTE | 1,368 |
| Peacekeepers-cut GF 15% | 27 | Investig cut 21 FTE (6 left) | 2,543 |
| PW-park maint to min levels | 185 | Patrol cut 31 FTE | 3,727 |
| PW-cut water use 50% | 165 | Subtotal Police Dept | 10,994 |
| PW-cut 1 FTE, fund shift to Gas | 170 | | |
| Subtotal Non-Safety Depts | 5,214 | Grand Total Cuts | 22,230 |

It would be difficult, however, to implement the Marshall Plan while simultaneously cutting other key elements of the Police Department. Table 11 shows that if the $11 million in Police cuts were spread to other departments, the percentage impact jumps to unsustainable levels: if both Police and Fire were held harmless from cuts of this magnitude, non-safety would suffer a 54% reduction in budget levels.

**Table 11**

**Sample Impact Assuming Re-Allocation of Contingent Cut List Among Safety and Non-Safety Departments ($ in 000)**

| ($ in 000) | Other Depts | Fire Dept | Police Dept | Totals |
|---|---|---|---|---|
| Cuts from Contingent List | $5,214 | $6,022 | $10,994 | $22,230 |
| % Cut (13-14 dollars) | 13% | 17% | 13% | |
| | | | | |
| No Cuts to Police | 11,125 | 11,105 | - | $22,230 |
| % Cut (13-14 dollars) | 27% | 31% | 0% | |
| | | | | |
| No Cuts to Police+Fire | 22,230 | - | - | $22,230 |
| % Cut (13-14 dollars) | 54% | 0% | 0% | |

These impacts are limited to the $22 million value of the cuts on the existing list. Cutting the entire $26 million needed to both balance the budget and fund the full Marshall Plan, without affecting the Police and Fire departments, would boost the cuts to the remaining non-safety departments from 54% to 62%. All of this comes on top of previously implemented cuts totaling 36% of total general fund expenditures. Even if none of these cuts came from the Police Department, this action would be like building a structure on a crumbling foundation. It would be difficult, if not impossible, to run the entire City without the administrative, planning, financial and other support functions that would be largely eliminated through an effort to balance the general fund budget, and pay for the Marshall Plan, without any additional resources.

CONCLUSION

It is recommended that the City Council call for a public hearing for July 9 and consider placing a tax measure before the voters for approval on November 5, 2013. On July 9 it will be recommended that the Council adopt the Resolution calling the election, and approve the Ordinance establishing the terms and conditions of a sales tax for consideration by the voters. First reading of the ordinance is done by Council and under state law the second reading is the action by voters at the election.