



City and Borough of Sitka

100 Lincoln Street • Sitka, Alaska 99835

MEMORANDUM

To: Mayor Paxton and Assembly Members

From: Keith Brady, Municipal Administrator *KB*

Date: 2-26-19

Subject: Informational: Presentation to Health Needs and Human Services

Summary

I had a conversation with Doug Osborne, the Chair of the Health Needs and Human Services (HNHS), on sustainability, a topic of the HNHS. One item was no taxes on groceries. We discussed loss of revenue and what it would take to be cost neutral. He invited me to give a presentation to the HNHS. Some of what we discussed was from the Citizens' Task Force.

In discussing taxation, there is always the topic of regressive and progressive taxes. Regressive taxes burden the poor and progressive burden the rich. What's "fair" is up for personal introspection. The Assembly formed a Citizens' Task Force (CTF) to grapple with some of these issues and force a conversation among Sitkans as to what level of services they are willing to pay for.

On September 14, 2015 the (CTF) had their first meeting to take a deeper look at Sitka's revenues and expenses and make recommendations on how to balance our community's budget. On April 12, 2016 they made their presentation to the Assembly.

The following link will take you to the full final report of the Task Force:

<https://www.cityofsitka.com/government/clerk/boards/info/ctf/documents/CitizensTaskforceFinalReport.pdf>

Below are excerpts from the final report:

A "perfect storm" of falling contributions from the state and federal government, stagnant local tax revenues, increasing municipal expenses due to the Blue Lake Dam Expansion project, deferred maintenance on other infrastructure, and rising costs of public employee benefits have combined to create a gaping hole in the City's budget. At the same time, a growing population of Sitka's residents and business owners face difficulties balancing their own budgets. Some seniors, people with disabilities and families raising children on low incomes face severe financial hardships, and are often forced to choose between paying for housing, food, medication or utilities. All trends suggest that these financial stresses will persist, as oil

prices remain low the state shifts the burden of expenses to local governments, and the cost of housing, electricity and health care continue to rise.

Despite these pressures, Sitkans want to maintain all of the elements that contribute to our high quality of life, from educational and healthcare opportunities to public safety, recreational services, and cultural facilities and programs. Unfortunately, the City simply does not have the revenue to pay for mandatory expenses and continue its current level of support for the services residents want.

There was a general desire on the part of Task Force members to make Sitka's structure of taxes and fees more progressive and sustainable. In other words, members agreed that its recommendations should make the City's revenue more predictable, and ensure that the tax burden on residents is reasonably related to their ability to pay. These became guiding principles in deliberations as options were discussed.

While many residents who took the time to attend Task Force meetings recommended cutting municipal expenses, pleas from citizens to maintain public services were also loud and numerous. During the review of the General Fund budget, Task Force members developed a consensus that the City could not maintain core infrastructure and public safety, meet its regulatory obligations, and maintain its commitment to community values through budget cuts alone. The numbers simply do not add up. A combination of spending cuts and revenue increases is a mathematical necessity if the City is going to avoid negative impacts on public safety, infrastructure, public education and quality of life.

The details of the Grand Bargain that the Task Force recommended to the Assembly are included in Addendum D. Elements of our Grand Bargain include:

1. Eliminating the sales tax on groceries for all Sitkans. This will represent a tax cut for most households but will be especially helpful to families raising children on low incomes, who spend a much higher percentage of their household budgets on food.
2. Directing 100% of the Fish Tax to the Harbor Fund, which will provide revenue for projects that benefit commercial fishermen, maritime businesses and recreational boaters. Currently, the General Fund retains 10 percent of the Fish Tax.
3. Institute a biennial vehicle registration tax of \$200. To reduce the impact on households with fixed incomes, the City could exempt one vehicle in households with at least one member over the age of 65.
4. Providing significant General Fund support for the Electric Fund to prevent unaffordable increases in electric rates. Rates will continue to rise, but at a reasonable pace with municipal support.
5. Investing \$3 million from the General Fund in capital projects per year. This amount will keep our streets and infrastructure from further deterioration.
6. Raising new revenues by selling City-owned undeveloped land. This action should spur housing construction and job creation in Sitka and also add new land to the property tax rolls.

7. Raising new revenues by opening a new rock quarry. Our existing quarries are almost depleted. A new rock source must be found to support public and private development and construction projects in Sitka.
8. Raising new revenue by asking the voters to approve an increase of 2 mills in the property tax rate.
9. Reducing the City's General Fund budget by a total of \$1.7 million over the next three years.
10. Reducing the City's contribution to schools by a total of \$600,000 over the next three years, with a "circuit breaker" that would require smaller cuts to prevent school funding from dropping below 92 percent of the cap according to the state funding formula.

The Grand Bargain proposed by the Task Force has many elements that combined, create the financial resources Sitka needs to maintain infrastructure, services and quality of life. Raising the property tax rate is an absolutely essential element of the plan. **Municipal leaders, taxpayers and voters need to understand that if a ballot initiative to increase the property tax is not conducted or fails to pass, major, unaffordable increases in electric rates, and much deeper cuts in core services will be required to balance the budget** (emphasis maintained from the report). While there are alternatives to raising the property tax, members of the Task Force believe that all of these options will be bad for Sitkans in general, and much worse for our most vulnerable residents with low and fixed incomes.

Recommendation

No recommendation, just informational. What is below is to show what has been done from the CTF recommendation and layout options that have already been brought up from CTF, Assembly and others with numbers as we have them. At the end is a utility decrease scenario from a millage rate increase. As with most things it is complex and is like a spider web when you pull one string it pulls the whole web. It seems that the Governor's budget will make us look at things differently and force us to have a conversation.

Details

Below are some options from the original CTF, with other ideas that have come up in conversation or at the table of Assembly Meetings. The list is not comprehensive, and there is a lot to absorb and consider.

With less money coming from the state and federal government, we are all going to wonder what we are to do next. Are we going to be a sustainable community? How are we going to be a sustainable community without the money that has come in before? A couple of years ago Governor Walker said that we are not in the middle of a fiscal crisis but an identity crisis. What do we want to be? How do we get there? If we take parts of the Grand Bargain as it was presented in 2016 (in reference to the above 10 things from the original CTF), let's see where we are now:

1. Eliminating sales tax. This is an idea that could be revenue neutral with an increase on the property taxes of 2 mills. This idea is included in item 8.
2. 100% of Raw Fish Tax to Harbor Fund. Already done.

3. Biennial vehicle registration. Not accomplished.
4. General Fund support for the Electric Fund. Look to item 8. The Electric Department was subsidized for 2 years. The first subsidy came from the Southeast Economic Fund, the second from the General Fund. However, there has not been an approved permanent subsidy to the Electric Fund since. It is problematic to tie a millage rate increase to utilities. One idea is to decrease or eliminate the interdepartmental service fees to the Enterprise Funds to allow utility rates, such as the electric rate to be lowered. Schools, investment in economic development, or roads might be more viable options to be tied to a millage rate.
5. Investing from General Fund for capital projects. In the recent past the average annual amount approved for General Fund infrastructure projects is \$2M. The Task Force stated in 2016 that the cost needed for infrastructure was really \$4M a year but they recommended \$3M to be able to handle maintaining city services via infrastructure. Today, because the \$3M wasn't or couldn't be funded, we are needing \$5M to take care of our deferred and non-deferred needs.
6. Sell City-owned undeveloped land. This has not happened due primarily to the landslide in 2015 and the landslide mapping process taken on by the state that was funded by a FEMA grant. The slide map is almost complete and we are currently working on a master plan for the No Name Mountain/Granite Creek area. We are finalizing the city's land inventory to take to the Planning Commission to go through the process to make these lands available to sell and develop. Along with this we have prepared an RFQ for the master plan for the development of No Name Mountain/Granite Creek area.
7. Revenue from new rock quarry. The development of No Name Mountain/Granite Creek master plan will take care of this and the need for another overburden pit.
8. Revenue from voter approved 2 mill property tax increase. There is a need for a discussion of an increased millage rate that is budget driven. This will be defined more below. If considered and approved, it could eliminate taxes on groceries and utilities and reduce the rates of the utilities. There are a lot of give and takes in these options.
9. Reduce General Fund budget. Significant progress has been made in achieving this goal.
10. Reduce City's contribution to schools. Significant progress has been made in achieving this goal.

Revenue

Looking above at 1,4, and 8: a reduction or elimination of taxes and service fees would need to be made up somewhere to have a net zero effect on the budget and maintain the level of services that the city is currently providing.

Taxes on Groceries	\$2M
Taxes on Utilities	\$1M
Intergovernmental Management Fees	\$2.8M

Intergovernmental Management Fees comes from the use of internal departments for all aspects of operations of city due to economies of scale (e.g. Legal, Finance, HR, etc.) including the enterprise funds (especially Water, Wastewater, Solid Waste, Electric, Port and Harbors, and GPIP). This is a very normal practice for municipal budgeting and auditing. Elimination of the Government fees would result in utility rate decreases with the loss revenue to the general fund potentially made up in the property tax. (See the scenario at the end.) A simple way of looking at this is \$1M revenue in taxes offset by 1 mill increase on property tax.

Transient Lodging Tax (TLT)

The total amount of tax revenue generated from TLT at 6% is \$503,298. With sales tax being a 5.5% average over the year collecting \$461,365.

TLT generated at 1%	\$83,883
Sales tax from Lodging at 6%	\$503,298
TLT at 12%	\$1,006,596

Currently, the taxes on lodging (hotels, motels, short-term rentals, etc.) are 6% sales tax and 6% TLT. Sales tax could be exempted on lodging and TLT raised to 12% for visitor enhancement. This was before the Assembly last year and was not approved.

With decrease in state funding to market Alaska tourism, we need to promote ourselves.

Marijuana Excise Tax

The total sales tax on marijuana is \$144,714. An additional Excise Tax at 3% would generate \$72,357:

Sales Tax on Online Goods

\$1M in sales online would produce \$60,000 of remitted taxes to the city. In our FY20 budget we are estimating \$360k as revenue from all online sales.

Alcohol Excise Tax

We have no data to draw from to know what the amount this would be for Sitka. This idea might be in jeopardy with the Governor's proposed bill.

Fuel Excise Tax

These assumptions are based on the State's rates and revenues from 2015 and reduced to match Sitka's population. Rates presented below are at **\$.01 per gallon**.

Highway (road) Fuel	\$572,971 (estimate probably high)
Marine Fuel	\$262,521 (estimate probably low)

Jet Fuel	\$315, 010
Aviation Gasoline	\$41,662

Highway fuel excise tax could be used for roads, sidewalks and other General Fund public infrastructure projects. Marine fuel could be for ports and harbors to help keep rates down. Jet fuel and aviation gasoline for the seaplane base and airport.

There already is a 6% sales tax on the fuel sales that is estimated at \$1.032M+ revenue to the city for marine, heating oil, and gasoline.

Property Tax

According to census data at: <https://www.census.gov/quickfacts/sitkacityandboroughalaskacounty> as of July 2017 56.6% of the 4220 housing units were owner occupied.

Every year-round home owner in Sitka could receive a homestead exemption of \$150k on their first home, the exemption would be approximately \$2.15M, based on the census numbers. Those receiving the homestead exemption would need to apply every year with some defined criteria, maybe similar to the PFD. This would eliminate the need for the senior property tax exemption and the audits.

Property Tax Rate	Revenue	Deduction	Total
6 mills (current)	\$7.1M	\$500k (senior property tax exemption)	\$6.6M
9 mills	\$10.65M	\$2.15M (homestead exemption)	\$8.5M
12 mills	\$14.2M	\$2.15M (homestead exemption)	\$12.05M

A budget driven mill rate, for example set at 12 mills, would max it out at 12 mills and the Assembly would be able to adjust the rate if revenue is up other places or the need wasn't there for capital projects.

Sales Tax

An argument has been made for a Kama'aina type discount for locals. Kama'aina is a Hawaiian discount given by businesses to residents of Hawaii. We have something similar in the Silver Saver card that the Chamber already offers for discounts from businesses. However, a reduction or exemption of sales tax for locals might be able to be developed.

The elimination of sales tax on groceries and utilities, could reduce the burden of the loss through the senior sales tax exemption if picked up through a millage rate increase.

In FY19 we estimated \$12.525M from sales tax. Collection trends in the calendar year 2Q & 3Q bring in 70%+ of the sales tax for the year. That is \$8.8M+ for the summer months and \$3.8M- for the winter months.

Tax Exemptions

The Sitka General Code (SGC) states that sales of goods, services and rent are taxable unless specifically exempted. In SGC 4.09.100 there are 26 cited exemptions to sales tax, these are:

- Casual Sales: A casual and isolated sale not made in the regular course of business (e.g. Facebook: Sitka-for sale, garage/yard sales, etc.)
- Church Sales
- Court Fixed Fees
- Dues and Fees. Dues or fees paid to become or remain a member of a labor union, fraternal organization or nonprofit organization that has obtained an IRC 501(c) tax exemption certificate are exempt.
- Federal and State Prohibitions
- Freight and Wharfage: Exempted by elements of federal and state law.
- Governmental Agencies: A sale directly to any federal, state, municipal or tribal government, or any department or agency of these governments, is exempt.
- Insurance. The sale of insurance policies, guaranty bonds, and fidelity bonds are exempt.
- Loans. The principal amount of the loan and the interest charged for loaning of money are exempt. Any fees associated with the loaning of money are subject to sales tax, unless exempt under other sections of this chapter.
- Medical and Veterinary Services
- Newspapers
- Nonprofit Charitable Organizations. Sales made by nonprofit charitable organizations which do not have paid employees and which do not keep normal business hours are exempt.
- **Outside City and Borough.** Sales of goods or services resulting from orders received from outside the city and borough by mail, telephone, or other similar public communication where delivery of the property or performance of services ordered is made outside the city and borough are exempt.
- **Over Twelve Thousand Dollars on Sales and Rents of Tangible Personal Property and on Sales of Services (i.e. Sale tax cap)**
- School Sales
- *Resale (Wholesale)*
- Student Transportation
- Service Performed by a Licensed Undertaker or Mortician

- Exemption for Games of Skill and Chance
- Government-Funded Agencies
- Child and Adult Dependent Care
- Public Transportation
- *Exemption for Persons Who Have Reached the Age of Sixty-Five*
- Youth Camps. Fees charged for nonprofit youth camps primarily serving persons under eighteen years of age are exempt.
- Residential Rent. Rent paid for residential housing for thirty or more consecutive days
- Sale of Service Costs or Commission

Using the 2016 data:

Total gross sales - \$363,237,383

Total exemptions - \$223,603,816 (61.6% of all gross sales are exempt)

Major exemptions and taxes foregone per year:

Sales Tax Exemptions	Annual Taxes Foregone	% of total Exemptions
<i>Wholesale for Taxable Resale</i>	\$2,851,589+	23.8%
Long-Term Residential Rent	\$311,181+	2.5%
Sales Outside Sitka	\$966,012+	7.9%
<i>Sales to Persons Over 65</i>	\$709,185+	5.8%
Sales To Governmental Entities	\$3,083,081+	25.1%
Sales To Qualifying Non-Profit Entities	\$263,602+	2.1%
Sales Over Taxable Transaction Limit	\$2,286,874+	18.6%
All Other Exemptions	\$726,686+	5.9%

Since 2016, the taxable transaction limit has been raised substantially, so without reliable data, we no longer are able to report the amount of exempt sales over the taxable transaction limit and sales taxes foregone. The amount must be estimated.

The sales categories with the most exempt sales, not exempted from taxation by federal or State laws, are:

- Wholesale for Taxable Resale- \$2,851,589+ in annual taxes foregone
- Sales Over Taxable Transaction Limit - \$2,286,874+ in annual taxes foregone
- Sales Outside Sitka- \$966,012+ in annual taxes foregone

While wholesale sales for taxable resale can be theoretically taxed, there is no example nationally of where it has happened and is not recommended.

The amount of taxes foregone due to the current taxable transaction limit can only be estimated.

Value Added Tax

A tax on the amount by which the value of an article has been increased at each stage of its production or distribution.

Donations

There is an idea that donations, or an opt in support, could also be made to special items the city has to pay for, such as the Performing Art Center, Crescent Harbor Playground, the Library. These items could be in a separate funds to monitor donations and expenditures.

New Utilities (Districts)

Some communities have a road and/or drainage utility built into their other utilities. It could be used in some areas like a Local Infrastructure District (LID). These would be project driven and include citizen involvement.

Utility Rate Decrease Scenario

The trade-off elements of a 3 mill increase to property taxes, for example, to reduce utility costs was divided in the following manner:

- 50% - Used to reduce electricity
- 16.3% - Used to reduce water
- 16.3% - Used to reduce wastewater
- 16.3% - Used to reduce solid waste

A reduction in utility rates would also reduce revenue of the sales tax by about \$156,400. However, as stated above utilities could be exempt of sales tax. Regardless, $\$3,000,000 - \$156,400 = \$2,843,600$ to reduce user fees:

Electricity

$$50\% \times \$2,843,600 = \$1,421,800$$

Total kWh generated - 107,000,000

$$\$1,421,800 / 107,000,000 = \text{a reduction of } \$0.0132/\text{kWh}$$

- Average annual residential usage = 18,000 kWh
- Average annual residential cost at the average current rate
 $18,000 \text{ kWh} \times \$0.158/\text{kWh} = \$2,844 + 5.5\% \text{ sales tax} = \$3,000$
- Average annual residential cost at the reduced rate
 $18,000 \text{ kWh} \times \$0.1448/\text{kWh} = \$2,606 + 5.5\% \text{ sales tax} = \$2,750$

$$\text{Annual Savings to Household: } \$3,000 - \$2,750 = \$250$$

Water

Current User Fee - \$49.45/month, \$593.40/year

$$16.3\% \times \$593.40 = \$96.92 + 5.5\% \text{ sales tax} = \$102.25$$

Annual Savings to Household: \$102.25

Wastewater

Current User Fee - \$59.09/month, \$709.08/year

$$16.3\% \times \$709.08 = \$115.81 + 5.5\% \text{ sales tax} = \$122.18$$

Annual Savings to Household: \$122.18

Solid Waste

Assume 48-Gallon Container for average residence

Current User Fee - \$32.96/month, \$395.52/year

$$16.3\% \times \$395.52 = \$64.60 + 5.5\% \text{ sales tax} = \$68.15$$

Annual Savings to Household: \$68.15

Total Annual Savings to Household

Electricity \$250.00

Water \$102.25

Wastewater \$122.18

Solid Waste\$68.15

\$542.58

Break-even point In Home Value (Where Increase in Property Tax = Decrease in Utility Fees)

\$542.58 / 0.003 = \$180,860 Home Value. With the homestead exemption the home value is at \$330,860, right about at the median home price as of the 2017 census data.

Effect on Various Home Values:

	Property	Utility	Net
Home	Tax	Fee	Effect
Value	<u>Increase</u>	<u>(Decrease)</u>	<u>(Decrease)</u>
\$50,000	\$150.000	\$ (542.58)	(\$392.580)
\$100,000	\$300.000	\$ (542.58)	(\$242.580)
\$150,000	\$450.000	\$ (542.58)	(\$92.580)
\$180,860	\$542.580	\$ (542.58)	\$0.000
\$200,000	\$600.000	\$ (542.58)	\$57.420
\$250,000	\$750.000	\$ (542.58)	\$207.420
\$300,000	\$900.000	\$ (542.58)	\$357.420
\$350,000	\$1,050.000	\$ (542.58)	\$507.420
\$400,000	\$1,200.000	\$ (542.58)	\$657.420
\$450,000	\$1,350.000	\$ (542.58)	\$807.420
\$500,000	\$1,500.000	\$ (542.58)	\$957.420
\$600,000	\$1,800.000	\$ (542.58)	\$1,257.420
\$700,000	\$2,100.000	\$ (542.58)	\$1,557.420
\$800,000	\$2,400.000	\$ (542.58)	\$1,857.420

\$900,000	\$2,700.000	\$ (542.58)	\$2,157.420
\$1,000,000	\$3,000.000	\$ (542.58)	\$2,457.420