



CITY COUNCIL AGENDA BILL 20-25

AGENDA BILL NO.: 20-25

TITLE: Ordinance 609 adopting new Chapter 3.31 NMC to establish utility tax and procedural regulations relating to same.

TOTAL PAGES: 24

ORIGINATING DEPT.: City Manager

EXHIBITS:

1. Proposed ordinance (Option A)
2. COVID-19 financial impacts to 6-year forecast (from 5/5/20 mtg)
3. Alternative ordinance (Option B)

ACTION PROPOSED: Discuss ordinance adopting utility tax and implementing regulations.

SUMMARY

The proposed ordinance, Option A (Ex. 1) adopts Chapter 3.31 of the Newcastle Municipal Code (NMC), which establishes a utility tax within the City, and procedural regulations relating to the tax. Council is requested to review several components of proposed ordinance and provide guidance to staff.

FISCAL IMPACT

The assessment of financial impacts caused by the COVID-19 emergency have been presented in the May 5, 2020, Agenda Bill 20-24, and more specifically in the memorandum, *Budget Impacts Due to COVID-19 Pandemic*, dated April 21, 2020, and *2020 Economic Recovery Sensitivity*. Ultimately, the analysis demonstrates that the COVID-19 emergency will cause an increase in Net Operating Deficit from the 2020 budget amount of \$896,260 to a range of \$1,124,735 - \$1,928,535. Without additional revenues made necessary to respond to COVID-19's financial impacts and depending upon the speed of the recovery, the City's General Fund is estimated to be below fiscal policy within the fiscal year 2021 and without cash by 2023 without significant reductions to city services such as public safety.

A utility tax placed on all eligible utilities at a rate of one percent is estimated to generate approximately \$293,000 per year. A three-percent utility tax is proposed in the draft ordinance and is estimated to generate approximately \$880,000 (\$293k x 3) per year. This revenue is based on both residential and commercial utility customers contributing.

Based on a total of approximately 5,500 residential dwelling units in the city, the average dwelling would pay just over \$10 a month in utility taxes. A smaller home or apartment may pay less and a larger home may pay more.

Based on the ratio of multifamily to single family units in Newcastle (1,500:4,000) and an analysis of household size, a reasonable range assumption would be approximately \$8 - \$14 a month.

BACKGROUND

General fund fiscal gap: The City has been working for several years to address a General Fund fiscal gap in its six-year forecast. In a 2011 Audit Exception, the Washington State Auditor's Office expressed concern about the City's long-term financial viability due to reliance on revenue sources susceptible to impacts from economic conditions, and noted that personnel cuts are a strategy that cannot be employed indefinitely. On April 7, 2015, the City Council adopted goals and strategic priorities that included development of a long-range financial plan, and on April 3, 2018, again reaffirmed this goal with the adoption of revised goals and priorities.

The adopted financial policies require the council to consider potential options to bring the six-year financial forecast into balance. The financial policies identify that, for budgetary purposes, one-time resources be identified and used to support one-time expenditures, and ongoing expenditure programs be supported by ongoing resources. Financial policies also direct the City to strive to maintain diversified and stable revenue sources as permitted by state law to shelter it from short-run fluctuations in any one revenue source.

During the budget process for 2020, the City Council explored ways to reduce a projected operating deficit of \$1.3 million, driven largely by increasing costs to fund police and fire services. In 2020, the service contracts with Bellevue Fire and the King County Sheriff's Office will increase \$700,000 combined, a 14 percent increase over 2019. While costs for policing are going up, the need for additional officers is also increasing due to a growing population. In response to the Council's prioritization of public safety, the 2020 budget includes the addition of a motorcycle officer to Newcastle's police force. A motorcycle officer is essential to traffic enforcement along busy Coal Creek Parkway where it is difficult for a full-sized police vehicle to pull over and enforce speeding violations.

The City's 2020 budget identifies that public safety expenditures (fire, police and jail) make up nearly half of the City's operating budget, and that property taxes cannot keep pace with public safety costs (City of Newcastle 2020 *Final Operating & Capital Budget*, p. 4). Public safety expenses are expected to annually consume all revenue from property taxes, which increases the City's need to review potential strategies and new revenue to address the six-year fiscal gap.

As noted in the Fiscal Impact section above, COVID-19's fiscal impact will cause an increase in Net Operating Deficit from the 2020 budget amount of \$896,260 to a range of \$1,124,735 - \$1,928,535. Without additional revenues made necessary to respond to COVID-19's financial impacts and depending upon the speed of the recovery, the City's General Fund is estimated to be below fiscal policy within the fiscal year 2021 and without cash by 2023 without significant reductions to city services such as public safety (police, fire).

Fiscal Sustainability Implementation Action Plan: On September 18, 2018, the City contracted with Management Partners to provide an independent review of the City's operating budget and six-year financial forecast. Management Partners' forecast confirmed that estimated expenditures would exceed estimated resources beginning in 2020, and that reserves were expected to be depleted by 2023 if no action was taken to reduce expenditures and/or enhance revenue. On January 18, 2019, the City Council approved a contract with Management Partners to prepare a Fiscal Sustainability Implementation Action Plan (Plan) to provide a financial outlook, comprehensive analysis of City operations, and provide strategies for expenditure changes, revenue enhancements, and potential efficiencies that could be adopted to address the fiscal gap.

On May 4, 2019, Management Partners presented to the City Council a preliminary analysis of budget strategies to address the General Fund structural deficit, including a new utility tax. On June 18, 2019, Management Partners provided a public presentation at a Town Hall meeting, where the City's finances, financial challenges, and possible ways to avoid deficit spending and budgetary shortfalls, including a utility tax, were discussed, and public input was provided to the City Council.

Due to the forecasted six-year general fund fiscal gap, the City Council has discussed the Plan and utility tax option at numerous meetings, and more specifically at the following meetings (links to agendas provided):

January 21, 2020 <https://newcastle.civicweb.net/filepro/documents/30167?preview=30169>

February 4, 2020 <https://newcastle.civicweb.net/filepro/documents/30392?preview=30394>

February 18, 2020 <https://newcastle.civicweb.net/filepro/documents/30644?preview=30646>

On February 18, 2020, the City Council passed Resolution 2020-812, which adopted the Plan to ensure the City remains fiscally viable. The Plan includes the implementation of certain strategies, such as increasing cost recovery from developers, decreasing internal costs, increasing collection of sales tax revenue, and adopting a utility tax. Resolution 2020-812 directs staff to take the steps identified in the Plan, and accordingly, the proposed ordinance (Ex. 1) is being brought forward for council discussion and guidance.

COVID-19. Two weeks after the Council passed Resolution 2020-812, the Governor of Washington proclaimed a State of Emergency due to the COVID-19 outbreak and current public health emergency. On March 6, 2020, the City Manager declared an emergency due to COVID-19 under RCW 38.52.070. On March 11, 2020, the World Health Organization classified the global spread of COVID-19 as a pandemic, and urged all governments to take action now to stem the spread of the disease.

On March 23, 2020, the Governor issued Proclamation 20-25, "Stay Home – Stay Healthy" which ordered all residents to stay home and non-essential businesses and projects to close, which the Governor has extended to May 31, 2020. The COVID-19 emergency is causing a sustained global economic slowdown, and an economic downturn throughout Washington state. There has been a substantial reduction in business activity, which impacts state and local commerce that support Newcastle's economic sustainability. Because of the unprecedented shut down of businesses in Newcastle and the fiscal impact to revenues on the City's 2020 budget, staff analyzed the range of financial impacts to the City resulting from the COVID-19 pandemic.

On May 5, 2020, the City Council considered COVID-19's impacts to the City's budget, and actions necessary to respond to the COVID-19 outbreak and emergency. The Council was presented with a financial analysis that looked at three recovery scenarios depending upon the severity of economic impact caused by COVID 19. Based upon assumptions used in fast, medium, or slow recovery scenarios, the impact to the General Fund increases the currently budgeted operating deficit of \$896,000 to a range of \$1.125 million to \$1.929 million, and escalates the depletion of the City's general fund reserves below policy in 2021 with complete depletion by 2022.

The May 5, 2020, agenda bill is located at the following link:

<https://newcastle.civicweb.net/filepro/documents/31426?preview=31427>

The need for additional revenues to respond to the COVID-19 emergency and its impacts to Newcastle's budget were substantiated at the May 5 meeting (Ex. 2). The significant budget deficits caused by COVID-19 will potentially undermine the City's ability to fund and sustain essential public services, such as public safety (police,

fire) to its citizens. Accordingly, to establish revenue in response to the COVID-19 emergency and its dire impacts to Newcastle's financial sustainability, the Council approved a motion directing staff to bring a utility tax ordinance to its next meeting as a necessary response to the COVID-19 outbreak and public health emergency. However, on May 12, 2020, the City Council approved a motion to bring the utility tax ordinance for consideration at its June 2, 2020, meeting.

DISCUSSION

Utility Tax Basics: The City is authorized under state law to impose excise taxes for revenue, such as utility taxes, for the privilege of engaging in all kinds of businesses and occupations within the City. RCW 35A.82.020.¹ Business and occupation taxes (B&O), utility taxes, sales taxes, and property taxes have been described as "the four main revenue sources provided to the state by the legislature."²

Municipal Research and Services Center (MRSC) published the following "Utility Tax" summary:

"Whom Can the Tax Be Levied Upon?

Utility Tax *May* be Levied Upon

- Cable TV
- Electricity
- Gas
- Sewer/Stormwater
- Solid waste
- Steam
- Telephone (including cell and pager)
- Water

Utility Tax *May Not* be Levied Upon

- Broadcast Satellite TV
- Internet Services
- Imposing Utility Taxes on Other Municipalities

(A 2014 court of appeals decision, *City of Wenatchee v. Chelan Pub. Util. Dist.*, holds that code cities may impose the tax on other municipalities providing utility service within their boundaries, on revenues derived from their proprietary activities. The reasoning of that court decision should apply equally to other classes of cities and to towns. For more information, see our 2014 blog post [Important New Court Decision on a City's Utility Tax Authority](#).)

What are the limits on the rate?

Limit of 6.0% (without voter approval)

- Electricity
- Gas
- Steam
- Telephone

[RCW 35.21.870(1). Cities may impose a higher rate with voter approval (majority vote).]

No Limit

- Sewer/Stormwater
- Solid waste

¹ RCW 35A.82.020 is the same authority for the imposition of B&O taxes.

² MRSC *Revenue Guide for Washington Cities* at 82.

- Water
- Cable TV - may not be "unduly discriminatory"; i.e., must be imposed at the same or a similar rate as is imposed on other utilities. Cable Communications Policy Act of 1984, 47 U.S.C. §542(g)(2)(A)."³

The use of utility tax revenue is not restricted and may be used for general fund purposes. Tax rate changes for electric, telephone, and gas utilities cannot take effect until sixty days after the enactment of such taxes. This gives private utilities the time needed to apply to the Washington Utilities and Transportation Commission for a rate adjustment to reflect the tax change.

Referendum process:

Non-emergency process: The City's authority to impose a utility tax and B&O tax come from the same statutory authority, RCW 35A.82.020. Under RCW 35.21.706, cities that impose a business and occupation tax for the first time or raise rates must provide a referendum procedure. The adopted plan also notes that the "implementation of a utility tax is subject to referendum." Accordingly, the proposed ordinance – Option A (Ex. 1) includes the referendum process set forth in RCW 35.21.706, which includes the following steps:

- Within 7 days of passage of an ordinance that includes a referendum provision, a referendum petition may be filed with the City's filing officer.
- Within 10 days of that request, the filing officer shall confer with the petitioner concerning the form and style of the petition, issue the petition an identification number and secure an accurate, concise and positive ballot title from the designated local official.
- The petitioner shall then have 30 days in which to secure the signatures of not less than 15% of the registered voters of the city as of the last municipal general election.
- The filing officer would then work with King County Elections to verify the sufficiency of the signatures on the petition and, if sufficient valid signatures are properly submitted, shall certify the measure to the next general election ballot within the city – or at a special election ballot.

Emergency process: As noted above, during non-emergency times, RCW 35.21.706 identifies the exclusive referendum process for the proposed utility tax ordinance (Ex. 1). However, during times of emergency RCW 38.52.070(2) authorizes the City to exercise powers, such as the levying of taxes, "in light of the exigencies of an extreme emergency situation without regard to time-consuming procedures and formalities prescribed by law (excepting mandatory constitutional requirements)." This provides a potential option during the COVID-19 pandemic emergency to waive the in-person, signature gathering procedures of RCW 35.21.706 and direct the utility tax ordinance be submitted to the November 3, 2020, general election. Such an option has been presented as an alternative ordinance – Option B (Ex. 3).

Council direction needed: The adopted Plan contemplated an April 2020 adoption of a utility tax ordinance; however, the Governor's Proclamation 20-25 Stay Home, Stay Safe has caused some delay in the discussion and implementation of the ordinance, which necessitates continued discussion and potential action in June to give King County elections sufficient time to certify a potential referendum to the general election.

When considering the proposed ordinance – Option A (Ex. 1), staff requests direction from City Council on several key details:

³ MRSC "Utility Tax": <http://mrsc.org/Home/Explore-Topics/Finance/Revenues/Utility-Tax.aspx>

- Effective date & Collection: The Plan identifies collection starting in October 2020 at 2% without the delay of a referendum vote. Due to the COVID-19 emergency, Section 5 of the proposed Ordinance instead identifies an effective date of January 2021 to allow the possibility of a vote to take place and provide time for Council to consider delaying implementation of the tax if approved (Section 5.b).
- Rate: Consistent with the Council's approved motion on May 5, 2020, the utility tax ordinance has established a rate of 3% for all utilities. The proposed ordinance proposes a 3% utility tax rate for all identified utilities (NMC 3.31.030), which needs Council confirmation.
- Rate increases: The next question to answer would be whether to include future utility tax increases in the proposed ordinance, or only include the 3% rate, as currently presented in the proposed Ordinance. As noted at earlier meetings, a utility tax ordinance could include future increases in the original ordinance. An advantage of including all potential future increases in an ordinance is that there would only be the need to go through a potential referendum process once. The downside is that asking the public to vote on a large increase all at once may increase the likelihood that a referendum vote would overturn the ordinance.
- Utilities: Staff also requests that Council confirm the types of utilities that should be included in the proposed ordinance. Currently, all eligible utilities are included: telephone (including cellular), gas, electricity, water, sewer, stormwater, cable television, and solid waste.
- Referendum process: The normal referendum process is identified in the proposed ordinance – Option A (Ex. 1.). An alternative ordinance - Option B has been also provided (Ex. 3), which waives the in-person, signature gathering steps and submits the utility ordinance to the November 3, 2020, election. Staff requests council to determine which process should be adopted.

JUNE 2 DELIBERATION PROCESS

Staff asks that Council begin by taking up the ordinance as proposed (Exhibit 1) and make its first decision whether to substitute the Option B text (Exhibit 3) in lieu of the Option A (Exhibit 1) text. The reason to start here is that the changes within the ordinance to implement Option B are comprehensive and require revisions throughout the text. If we started with other questions, like the effective date or tax rate, and then substituted Option B, it would undo Council's earlier work. This order makes it easier for the Council, public, and staff to track the less complicated but still very important details that may need amendments (i.e., effective and collection date, rate, rate increases, and which utilities to include).

The proposed steps follow (motion texts are provided below in capital letters):

1. Staff presentation. Respond to Council questions.
2. Motion and second to adopt Exhibit 1 (Option A), but do not vote immediately.
3. Accept public comment on the ordinance.
4. Council discussion/deliberation
5. Motion and second to amend the ordinance by substituting the Option B text (Exhibit 3) if wanted.
6. Discussion of Option B (Amendment 1) and the alternate referendum process.
7. Vote on Amendment 1 to substitute the text of Option B. This is not the vote on the overall Ordinance.
If this vote passes, Council could continue to amend the Option B text (Exhibit 3) in other ways. Otherwise, if Amendment 1 fails, further amendments to Option A (Exhibit 1) would happen next, if wanted.
8. Motions and votes to adopt other amendments, as needed (i.e., effective and collection date, rate, rate increases, and which utilities to include, etc.).

9. Final Council comments on the ordinance.
10. Vote on the ordinance as amended. Whether this is basically Option A or Option B depends on the vote in 7 above. This is the final vote on the ordinance.

ACTION RECOMMENDED

Staff seeks Council direction on the items discussed above, and a motion relating to final action on a utility tax ordinance or directing staff to bring back an ordinance incorporating Council's guidance.

1. MOTION: I MOVE TO ADOPT ORDINANCE 609 OF THE CITY OF NEWCASTLE, WASHINGTON, ADOPTING A NEW CHAPTER 3.31 OF THE NEWCASTLE MUNICIPAL CODE TO AUTHORIZE AND LEVY UTILITY TAXES AS PRESENTED IN EXHIBIT 1 TO AGENDA BILL 20-25.
2. AMENDMENT 1 (OPTION B): I MOVE TO AMEND ORDINANCE 609 BY SUBSTITUTING IN ITS ENTIRETY THE ORDINANCE TEXT AS PRESENTED IN EXHIBIT 3 TO AGENDA BILL 20-25, WHICH PROVIDES FOR THE SUBMISSION TO THE QUALIFIED ELECTORS AT AN ELECTION TO BE HELD ON NOVEMBER 3, 2020, OF A PROPOSITION APPROVING OR REJECTING THE CITY'S ADOPTION OF A NEW CHAPTER 3.31 OF THE NEWCASTLE MUNICIPAL CODE TO AUTHORIZE AND LEVY UTILITY TAXES.

OTHER ACTION ALTERNATIVES

Provide staff with alternate direction.