CITY OF BELVEDERE

FINANCE COMMITTEE
AGENDA

October 20, 2021
Via Zoom
11:00 a.m.

Join Zoom Meeting
https://us02web.zoom.us/j/81625732464?pwd=ZEE0RVJKMzVtZnJBV0t5dUpiVVJaZz09

Meeting ID: 816 2573 2464
Passcode: finance (7459821)

Dial by your location:

833 548 0282 US Toll-free	888 788 0099 US Toll-free
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Find your local number: https://us02web.zoom.us/u/kz5sbdQFG

1. Approve minutes of July 30, 2021 Finance Committee meeting.
2. Discuss recommendation from Taskforce on Critical Infrastructure Financing.
3. New business.

Adjourn

Attachment:

A. Belvedere Taskforce on Critical Infrastructure Financing:
   Recommendation to Finance Committee

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Date posted: October 19, 2021

FINANCE COMMITTEE
July 30, 2021
11:30 AM
on Zoom remote platform

MINUTES

COMMITTEE PRESENT:	Bob McCaskill, Greg Ostroff, David Walker, John Wilton, Sally Wilkinson
COMMITTEE ABSENT:	Justin Faggioli, Steve Block
OTHERS PRESENT:	City Manager – Craig Middleton, Admin. Services Manager – Amber Johnson

CALL TO ORDER OF REGULAR MEETING

The meeting was called to order at 11:30 a.m.

SCHEDULED ITEMS

1. *Approve minutes of April 20, 2021, Finance Committee meeting*.

MOTION: Approve the minutes of the April 20, 2021, meeting.
MOVED: By Wilton, seconded by Ostroff; approval was unanimous.

2. *Discuss formation of Taskforce on Levee Improvement Financing*.

Committee Member Wilkinson proposed the creation of a Taskforce, composed of certain members of the Finance Committee, tasked with analyzing financing options available to the City for its upcoming levee improvement project. City Manager Middleton reported that Bond Counsel has been retained by the City and is preparing a written report on the legality of various financing options. Committee Members Ostroff and Wilton requested to see documentation that provided a description of the levee improvement project. The Committee agreed that a Taskforce should be created. The Committee instructed staff to edit the draft charter document included with the agenda packet, changing the report-by date and potential extension-request date to September 30, 2021 and requiring bi-weekly meetings.

MOTION: Creation of Taskforce on Levee Improvement Financing, composed of Committee Members McCaskill, Ostroff, Wilkinson and Wilton; adoption of charter with edits as discussed.
MOVED: By Walker, seconded by Ostroff; approval was unanimous.

ADJOURN

The meeting was adjourned at 11:48 a.m.

THE FOREGOING MINUTES were approved at a regular meeting of the Finance Committee on October 20, 2021 by the following vote:

AYES: _
NOES: _
ABSENT: _
ABSTAIN: _

APPROVED ____________________
Bob McCaskill, Chair

ATTEST ________________________________
Amber Johnson, Director of Admin. Services

Belvedere Taskforce on Critical Infrastructure Financing:
Recommendation to Finance Committee

Date: October 18, 2021

Background

On July 30, 2021, the City of Belvedere's Finance Committee established a Brown Act *Taskforce on Critical Infrastructure Financing* ("taskforce"), comprising four of its seven members (Bob McCaskill, Greg Ostroff, Sally Wilkinson, and John Wilton). The taskforce was assigned the job of analyzing options for financing critical infrastructure improvements to San Rafael Avenue and Lower Beach Road, a project which is estimated to cost $28 million, including a 30% contingency. The taskforce met four times in public session over the course of three months. Councilmember Jim Lynch attended meetings as a member of the public. This report provides a summary of its analysis and recommendations.

Professional Advisors

The taskforce relied on various outside advisors to complete its work, as follows:

- Bond Counsel: Brian Forbath of Stradling Yocca Carlson & Rauth
- Ballot Counsel: Sky Woodruff of Myers Nave
- Financial Advisor: James Fabian of Fieldman Rolapp & Associates
- Polling Consultant: Bryan Godbe of Godbe Research
- Political Consultant: Charles Heath of TBWB Strategies

Debt-Free Financing Options

The taskforce began its work by considering the scope to fund a $28 million critical infrastructure project (CIP) from the City's current budget and/or reserves. It concluded that the City's $8.6 million annual budget is fully assigned, and its $3.5 million operating reserve is intended to cushion against catastrophic loss, not finance capital improvements.

It discussed the appeal of grant funding and encouraged staff to aggressively pursue state and federal funding options, which it is doing with the help of a grant writer. At the same time, it acknowledged the improbability of securing $28 million in grants for such a local project. Given the urgency of the CIP, which will be shovel ready by 2023 and is expected to take two years to complete, the taskforce accepted that the City will likely have to borrow funds to pay for the project and must create a new revenue stream/or streams to repay that debt. The amount borrowed could be scaled down if grant funding is forthcoming.

Legal Restrictions on Local Government Taxes and Debt

The taskforce set about understanding the complex legal rules on issuing debt and introducing new taxes in California. <u>In broad terms, municipalities cannot issue debt without first introducing a new tax stream to pay debt service and the electorate must approve the tax by a two-thirds supermajority.</u> The rule is commonly known as the balanced budget rule or debt limit. It is intended to force municipalities to maintain budget balance, and only accumulate debt if at least two-thirds of the electorate consents ahead of time to pay the higher taxes needed to repay that debt, thereby ensuring intergenerational equity. Moreover, <u>only certain taxes can be pledged as sources of repayment for municipal debt</u>.

<u>Taxes that cannot be pledged as sources of repayment for debt</u> can typically be adopted with a simple majority vote of the electorate and are normally used to help fund general expenses on an ongoing basis. In practice, these tax streams <u>may also be leveraged in indirect ways to fund debt</u>, by using legal exceptions

to the debt rule to issue debt without a public vote. The "lease exception" is commonly used by municipalities to issue lease revenue bonds to pay for capital projects. The newly created tax receipts may, in effect, be used to make annual lease payments. The taskforce therefore concluded that it should study all possible tax streams, not just those authorized to be directly pledged to repay debt. After that, it would explore how to leverage the chosen revenue stream/streams to issue debt.

Debt Service Costs

In ballpark terms, the City's financial advisors estimate that annual debt service on a $28 million bond will be approximately $1.5 million, based on 30-year maturity (matching the useful life of the assets) and a 3.5% interest rate (cushioning for a backup in market rates from current levels).

Desired Tax Features

The taskforce discussed the desired characteristics of a tax to pay for the CIP and agreed that taxpayer equity (who pays, who benefits), voter appeal, revenue certainty and administrative ease are all important considerations. It parsed the issue of who benefits from the infrastructure improvements and concluded that all residents gain from the hardening of utility trunk lines and critical access roads afforded by the CIP. That said, there was broad agreement that owners of more valuable properties, with more expensive assets at risk, should pay more tax than owners of less valuable properties.

Funding Streams

The taskforce discussed the range of possible tax streams capable of generating $1.5 million annually. It ruled out local add-on sales taxes, business taxes and transient occupancy taxes given the City's minimal commercial activity. Utility user taxes were also discarded given the small number of residences in Belvedere. It identified four possible options: a parcel tax, a Mello-Roos tax, an ad valorem property tax, and a real property transfer tax.

Table 1: Taxes Levied by California Local Governments

Tax	Description
Ad Valorem Property Tax	A levy on property based on property's assessed value and used for voter approved debt.
Parcel Tax	A levy on property, typically a fixed amount per parcel. Cannot be based on a property's value.
Sales Tax	A levy on the retail sale of tangible goods.
Transient Occupancy Tax	A levy on the occupancy of hotels, motels, or other short–term lodging.
Utility User Tax	A levy on the use of utilities, such as electricity, gas, or telecommunications.
Business Tax	A levy on operators of businesses.
Mello Roos Tax	A levy on property in a defined zone, typically a fixed amount per parcel. Cannot be based on property's value.
Real Property Transfer Tax	A one-time levy on the sale of property based on the property's sales price.

Source: Legislative Analyst's Office

Option 1: Parcel Tax

A parcel tax is an annual tax levied at a fixed amount per parcel (or per room or per square foot). There are 935 taxable parcels in Belvedere, thus a parcel tax to fund the CIP would cost roughly $1,600 per parcel per year. Members felt that a parcel tax was not the right funding vehicle and were particularly concerned about the ability of elderly residents living on fixed incomes to pay the tax.

Table 2: Key Parcel Taxes in Belvedere 2021-22

Tax	Tax Per Parcel
Reed Union School District[1]	$624.58
Tamalpais Union High School District[1]	$483.68
Belvedere Fire Tax	$906.00
Sanitary District 5	$1,987.00
Belvedere Tiburon Library Agency	$66.00
Marin Municipal Water District	$75.00

[1]Seniors' exemption. Source: Marin County Tax Collector

Option 2: Mello-Roos Tax

A Mello-Roos tax is a levy on property in a defined zone, known as a Community Facilities District, used to finance infrastructure investment and some public services. The tax cannot be linked to property values, but otherwise the formula for apportionment is flexible, including its frequency. The taskforce was unable to create a formula which it believed was equitable. The option was dropped.

Option 3: Ad Valorem Property Tax

An ad valorem property tax is an annual levy on property charged in proportion to a parcel's assessed value (over and above the standard 1% ad valorem levy provided by Proposition 13). The proceeds must be used for voter-approved debt tied to a specific infrastructure project. The total assessed value of properties in Belvedere currently stands at $2.6 billion (2021-22 property tax roll), thus an ad valorem property tax to fund the CIP would cost taxpayers annually about 5.6 cents per $100 of assessed value, or put another way, $560 per $1 million of assessed value (assuming level debt service – see later discussion).

Table 3: Ad Valorem Property Taxes in Belvedere 2021-22

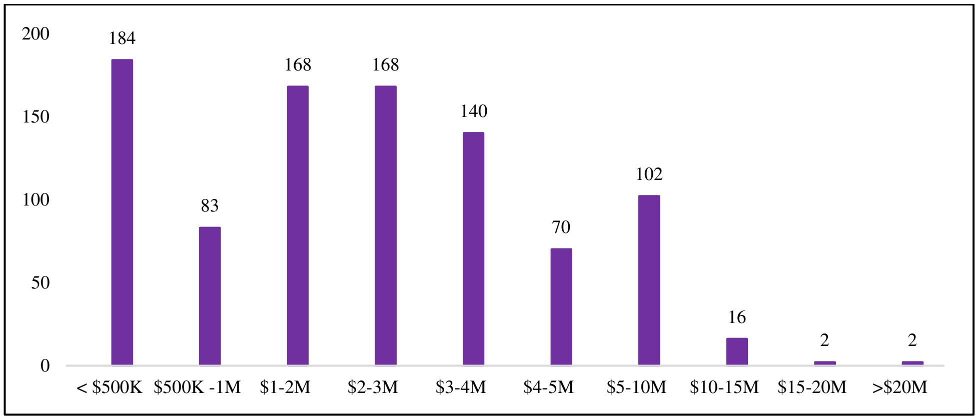
Tax	Tax Rate Per $100 of Assessed Value
Basic Tax	100.00 cents
School Bonds	7.66 cents
Health Bonds	2.18 cents

Source: Marin County Tax Collector

The taskforce reviewed the data on assessed values in Belvedere and noted the often-wide gap between a property's assessed value and its market value. Assessed values are based on 1978 property prices indexed for inflation. They are only rebased to fair market value when a property is sold or remodeled. Chart 1 shows the distribution of assessed values in Belvedere by valuation band, based on the 2020-21 property tax roll.

The taskforce discussed the imperfect nature of tying a tax to assessed values, but also noted that all properties do eventually change hands, and then the property tax burden shifts more heavily to those newly assessed properties. They also noted that an ad valorem tax cannot be used to fund ongoing maintenance of the capital improvements. Members saw value in the revenue certainty of this option (the tax is simply levied until the debt is repaid) and the ease of collection, as a new line item on property tax bills. They also noted that elderly people living on fixed incomes tend to live in properties that have not been reassessed for many years and would therefore pay minimal tax. It concluded that, of the choices, this was an option worth pursuing in more detail.

Chart 1: Belvedere Assessed Values by Valuation Band (Number of Properties)



Source: City of Belvedere 2020-21 Property Tax Roll. Total assessed value of 935 taxable parcels = $2.53 billion

Option 4: Real Property Transfer Tax

A RPTT is a one-time levy on the transfer of real estate based on a property's selling price. Exclusions are given for transfers that do not constitute a sale. RPTTs are commonplace throughout California, albeit not in Marin, and are add-ons to the 0.11% documentary transfer tax that all cities charge. Buyers and sellers are most often made jointly and severally liable for the tax and the decision over who pays is part of the contract negotiation.

Table 4: California Cities with Real Property Transfer Taxes

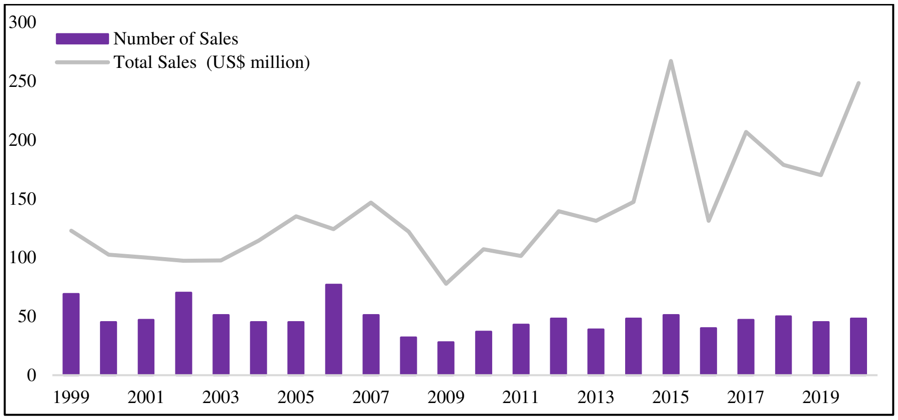
City	RPTT Rate	City	RPTT Rate
Alameda County		**Marin County**	
Alameda	1.20%	San Rafael	0.20%
Albany	1.15%	**Sacramento County**	
Berkeley	Banded from 1.50% to 2.50%	Sacramento	0.275%
Emeryville	1.20%	**San Francisco County**	
Hayward	0.85%	San Francisco	Banded from 0.50% to 3.00%
Oakland	Banded from 1.00% to 2.50%	**San Mateo County**	
Piedmont	1.30%	San Mateo	0.50%
San Leandro	0.60%	**Santa Clara County**	
Contra Costa County		Mountain View	0.33%
El Cerrito	1.20%	Palo Alto	0.33%
Richmond	Banded from 0.70% to 3.00%	San Jose	Banded from zero to 3.00%
Los Angeles County		**Solano County**	
Pomona	0.22%	Vallejo	0.33%
Redondo Beach	0.22%	**Sonoma County**	
Santa Monica	0.30%	Petaluma	0.20%
		Santa Rosa	0.20%

Source: California City Finance

The taskforce discussed the positive features of a RPTT. First, given the strength of Belvedere's real estate market, a tax on property sales could generate significant revenue. Belvedere sees about 50 property sales per year, with the average selling price now trending around $4 million, generating over $200 million in annual property sales. A 1.0% RPTT, for example, would therefore generate an estimated $2 million annually, easily covering debt service. Second, although only a fraction of taxpayers would pay the tax in any given year, Belvedere properties change hands, on average, every twenty years, so nearly everyone would eventually pay the tax. Third, the administrative lift would be low, with the tax collected by the

County of Marin alongside the existing documentary transfer tax (for a small per-transaction fee). Fourth, the tax could be used to fund ongoing maintenance of the capital improvements.

Chart 2: Belvedere Property Sales 1999-2020



Source: Author's calculations using documentary transfer tax data provided by Marin County Recorder

The taskforce also discussed certain challenges associated with the RPTT option. First, property sales are not guaranteed, creating a volatile and uncertain RPTT revenue stream. Second, RPTT revenues cannot be directly pledged as a source of repayment for debt, so a more complex financial structuring would be required (see next). Third, under the California Constitution, only charter cities can adopt RPTTs, and the City of Belvedere is currently a general law city. Conversion, the taskforce learned, is relatively simply, with few downsides and some soft benefits in terms of local control. On balance, the taskforce felt the RPTT option was worth pursuing, in parallel with the ad valorem property tax option.

Table 5: Ad Valorem Property Tax vs RPTT (Key Features)

Feature	**Ad Valorem Property Tax**	**Real Property Transfer Tax**
Frequency of tax	Annual	Once, when property is sold
Revenue certainty	High	Volatile
Administration	Easy	Easy
Fairness	Medium/High	Medium/High
Source of repayment for debt	Yes	No
Fund ongoing maintenance	No	Yes
Complicating factors	None	Requires charter city conversion

Source: Author

Debt Financing

Next, the taskforce discussed how an ad valorem property tax and a RPTT could be leveraged to support debt.

1. Ad Valorem Property Tax/GO Bond Issue

An ad valorem tax is specifically designed as the funding source for a General Obligation (GO) Bond. By approving an ad valorem property tax, the taxpayer is essentially agreeing to tax itself at an amount necessary to make annual debt service on the bond, until the debt is repaid, at which point the tax sunsets. The bond is backed by the full faith and credit of the issuing municipality, based on its ability to levy the tax on its residents.

GO bonds can either be structured with level debt service or escalating debt service. **Level debt service** means that debt payments are roughly the same in nominal terms from year to year. As assessed values grow, the tax rate declines. According to the City's financial advisors, the annual tax rate on a $28 million GO level debt service bond would decline from an estimated 5.6 cents to 1.8 cents per $100 of assessed value (equivalent to $560 and $180 per $1 million of AV) over the 30-year life of the bond. With **escalating debt service**, the tax *rate* is kept broadly steady over time, thus nominal debt service payments increase over time as assessed values rise. The financial advisors estimate that the average annual tax rate using escalating debt service would be 3.3 cents per $100 ($330 per $1 million) of assessed value over the life of the bond. Because escalating debt service pushes more of the repayment stream into the outer years, interest costs - and therefore aggregate debt service costs - are higher than using level debt service. Nevertheless, the taskforce agreed that using escalating debt service was a superior option, to lessen the upfront burden on pocketbooks, and allow the tax charge to rise in line with rising incomes.

Overall, debt financing using an ad valorem tax as the source of repayment is straightforward and offers the lowest costs of financing available to a municipality. Based on Belvedere's overall excellent financial standing, the City is likely to secure a strong AA category credit rating. The same rating category would apply to the GO bond.

Table 6: Estimated Tax Rates to Service $28 million 30-Year GO Bond

Tax	Level Debt Service	Escalating Debt Service
Starting Tax Rate	5.6 cents per $100 of AV	3.6 cents per $100 of AV
Ending Tax Rate	1.8 cents per $100 of AV	3.3 cents per $100 of AV
Average Tax Rate	3.4 cents per $100 of AV	3.3 cents per $100 of AV
Total Debt Service	$46,300,000	$51,100,000

Assumes 4.0% annual growth in aggregate assessed values and 3.5% interest rate. Source: Fieldman Rolapp & Associates, Inc

2. Real Property Transfer Tax/Lease Revenue Bond

Issuing a debt financing using RPTT proceeds is more complicated. Under the California Constitution, RPTT revenues cannot be pledged directly as a source of repayment for debt. However, the City is permitted to issue lease-revenue bonds secured by $28 million of City assets and *de facto* use RPTT revenues as the source of repayment on the bonds. Because lease financing is considered an expense and not a debt under the California Constitution, lease revenue bonds do not need voter approval.

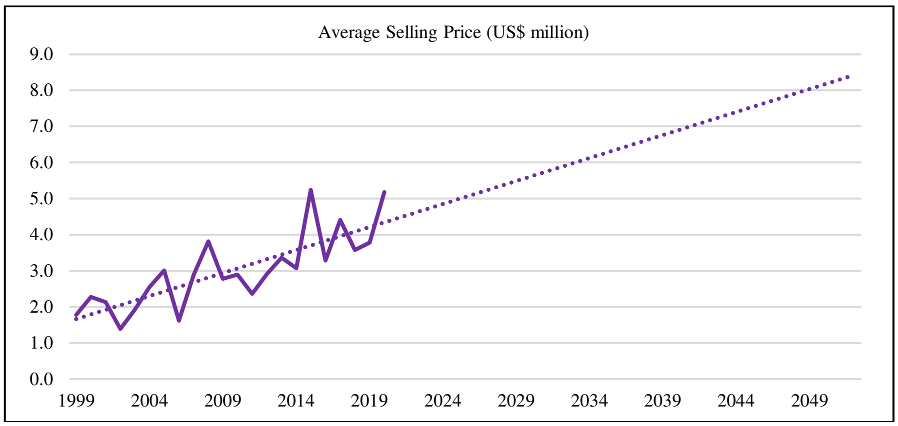
In vanilla terms, a lease revenue bond is a tax-exempt bond issued by a municipality that is secured with revenues generated by leasing out public assets to a third party. In practice, municipalities are allowed to lease those assets to themselves. The municipality leases the asset to a special purpose financing authority for a nominal fee, which leases the asset back to the municipality in return for annual lease payments. The financing authority can issue lease revenue bonds secured by those lease payments, up to the full value of the asset.

The taskforce worked with bond counsel to understand which City assets could be included in the lease. The upgraded levees could eventually become the leased asset, but not during construction, because the asset must be available for beneficial use for the lease to be valid. Other public assets would need to be assigned during construction. Staff determined that the combined value of City Hall, Community Park and Tom Price Park would likely exceed $28 million based on market comps, subject to appraiser verification. Lease financing arrangements are already in use at the City of Belvedere. In 2017, it signed a 15-year lease-leaseback of its corporation yard, with $2.6 million of funds released to pay down part of the City's unfunded pension obligation.

Under a lease financing structure, the lease would be secured by the City's general fund. RPTT revenues would flow into the general fund and would be critical in ensuring market confidence in the City's ability to make timely lease payments. The financial advisors advised adopting a **1 percent RPTT tax rate** given the volatility of the income stream, which they believe would allow the lease revenue bond to secure a debt rating just one notch lower than a GO bond. Financing costs would therefore be about 25 basis points higher than for a GO bond, based on conservative assumptions about market spreads. Unlike GO bonds, annual lease payments must be flat in dollar terms over time, ruling out the option of escalating debt service.

The taskforce discussed the real possibility that RPTT revenues exceed debt service costs by an increasing margin over time, as sales values move higher. The lease could be structured with various call provisions and the tax would sunset once the lease is paid off (subject to a vote of the electorate).

Chart 3: Trend Analysis of Average Selling Price of Belvedere Properties

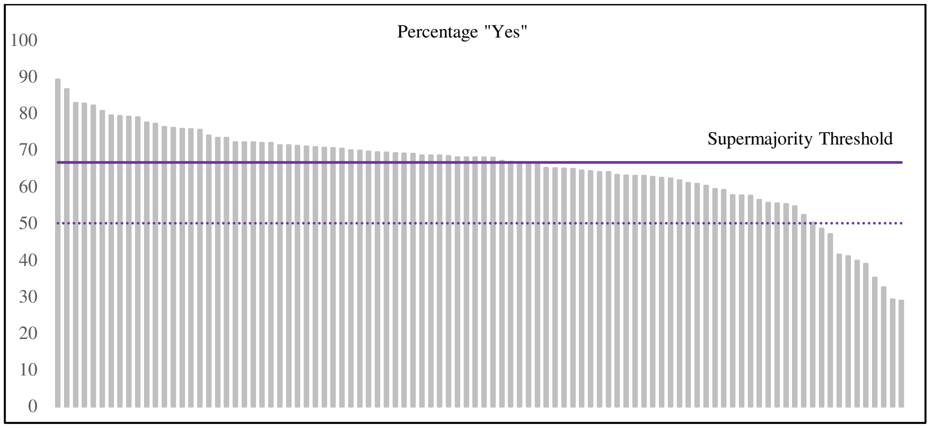


Source: Author's trend analysis based on historic documentary transfer tax data

Political Considerations

The taskforce moved on to discuss non-financial factors that might favor one tax over the other, notably vote thresholds and election timing. It learned that adoption of an ad valorem property tax requires supermajority (two-thirds) approval by Belvedere voters. There are four dates on which ad valorem property tax/GO bond elections can be held in any given year. The dates differ between odd and even years. By contrast, adoption of a RPTT requires only simple majority approval of the Belvedere electorate. Charter city conversion also requires simple majority approval, and the two questions can be combined into a single ballot question. The vote must coincide with the general election of City Councilmembers, held in November of even years i.e., the next opportunity would be November 2022. The taskforce discussed the difficulty of reaching a two-thirds threshold, based on historic election results. According to the California Debt and Investment Advisory Commission, between 2006 and 2020 there were 96 GO bond/ad valorem property tax measures on the ballot in California. 53 of them passed the supermajority threshold. Of the 43 failing measures, all but ten received majority voter approval. Super majorities are hard to achieve. Simple majorities are not.

Chart 4: California GO Bond Results 2006-2020



Source: California Debt and Investment Advisory Commission

Weighing the Options

The taskforce weighed the two tax options. Members were drawn to the simplicity and familiarity of the ad valorem property tax and the fact that it supports cheap, flexible financing. But members also surmised that the electorate might favor the RPTT option, as a one-time tax at a moment of high liquidity. Members also noted the fact that there is personal choice involved in the decision to sell a house, and thus pay the RPTT, whereas the ad valorem charge takes away personal choice. They also liked the fact that a RPTT could be used to support ongoing upkeep of the critical infrastructure improvements, which an ad valorem tax cannot. Members mused the idea of introducing both taxes at lower rates, but the City's consultants advised against putting two taxes on the ballot. Ultimately, the taskforce concluded that with two very credible tax options on the table, it should poll likely voters to see which option voters might prefer, before making its recommendation to the full finance committee.

Polling

Councilmembers Lynch and Wilkinson, alongside staff, worked with the City's pollsters, Godbe Research, to develop the poll. Brown Act considerations prohibited the full subcommittee from being involved in the design of the poll. The poll targeted likely voters in Belvedere and ran for 19 days in late September/early October. 268 returns were counted, representing a good sample size. Although the results are still being analyzed, the numbers look promising and both taxes appear to have good community appeal. Of the two options, the RPTT has greater chance of success at the ballot box because of the lower threshold (50%+1) that is required for passage.

Taskforce Recommendation

Based on its complete analysis, including likely success at the ballot box, the taskforce therefore recommends the City ask voters to approve adoption of a RPTT as a general tax, allowing it to issue lease revenue bonds to finance critical infrastructure improvements to San Rafael Avenue and Lower Beach Road.