



# CITY OF SACRAMENTO

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## DEPARTMENT OF FINANCE

BUDGET DIVISION

February 12, 1986  
FA:86080:BM:KMF

Budget and Finance Committee  
Sacramento, California

Honorable Members in Session:

**SUBJECT:** Utility Users Tax

### SUMMARY

This report reviews the status of the Utility Users Tax revenues and evaluates the range of potential effects which indexing would have on this revenue source as well as the changes which would be required for implementation.

### BACKGROUND

Staff has been requested to report back on the revenues generated by the Utility Users Tax and to evaluate the impact of indexing the Utility Users Tax rate. Separate discussions are provided below on (1) the overall revenue structure of the General Fund, (2) the revenues generated by the different utility sources, (3) the options for indexing the tax, and (4) the administrative changes which would be required to implement indexing.

General Fund Revenues. In order to put into perspective the overall effects of any changes in the Utility Users Tax rate it is necessary to also look at the other sources of General Fund revenues. Table 1 presents a forecast of the General Fund and Revenue Sharing revenues between 1985-86 and 1990-91. Total General purpose revenues are forecast to grow by about 38% during this 5-year period which in real terms represents an average growth of about 2.5% each year. If the growth in the Utility Users Tax revenues was limited to just the CPI, overall General Purpose revenues would grow by about 27% over the next 5 years, or about 0.5% each year in real terms. The point is that the real growth in the Utility Users Tax revenues is critical if the overall General Fund is to continue growing.

**TABLE 1**  
**GENERAL PURPOSE REVENUES**  
(\$'s in 000)

	85/86	86/87	87/88	88/89	89/90	90/91
	-----	-----	-----	-----	-----	-----
Taxes	\$91,489	\$101,210	\$111,236	\$122,079	\$134,704	\$148,393
Licenses & Permits	3,403	3,683	3,909	4,013	4,100	4,156
Fines & Forfeits	1,194	1,224	1,255	1,286	1,318	1,351
Use of Money & Property	3,875	3,645	3,783	3,868	3,935	3,943
Intergovernmental	12,894	12,744	12,965	13,151	13,423	13,815
Charges for Current Service	8,088	7,375	7,685	7,919	8,159	8,398
Miscellaneous	671	586	586	586	586	586
Revenue Sharing	5,334	-0-	-0-	-0-	-0-	-0-
	-----	-----	-----	-----	-----	-----
Totals	\$126,948	\$130,467	\$141,419	\$152,902	\$166,225	\$175,642
	=====	=====	=====	=====	=====	=====
% of Change		2.7%	8.4%	8.1%	8.7%	5.7%

The overall growth of the fund is particularly important at this time if Federal reductions are to be absorbed without operating reductions. The most direct Federal reduction that will impact the City is the loss of Revenue Sharing. This source alone contributed over \$5 million each year to support general government activities. Other effects of the Gramm-Rudman and Tax Reform policies will negatively impact the City's ability to debt finance. This could result in projects not being done, or perhaps delayed until they could be paid for in cash. The City may also be asked to take on additional new responsibilities as other related agencies experience federal cut backs. A few examples would be the housing and capital projects currently funded with CDBG money in the Redevelopment Agency, or Light Rail/Regional Transit as transit subsidies are cut back.

Utility Users Tax Revenues. Table 2 is based on data prepared by the City's economic consultant, Patterson Research Associates. It identifies the revenues generated from the Sacramento Municipal Utility District (SMUD), Pacific Gas and Electric (PG&E), and a composite number for the 13 telephone companies which collect revenues for the City.

The revenue estimates for SMUD do take into account the two 14% rate increases which were set by the District in calendar year 1985. The

estimated growth for all of the utilities in Fiscal Year 1986-87 is predicated on the econometric model that Patterson has created and is not based on date specific rate increases.

In order to more specifically evaluate the impact of recent SMUD increases on the City's Utility Users Tax revenues we directed Patterson to compare the latest economic forecast for the Sacramento area, which explicitly takes into account both of SMUD's 14% rate increases, to earlier forecasts which assumed a more gradual increase in electricity rates tied to projected increases in inflation, wage rate, energy prices, interest rates, construction prices and other factors that affect SMUD's costs. The regional economic model was then re-simulated to measure the impact on the baseline revenue forecast. The result was an "unanticipated" revenue increase of about \$680,000 in 1985-86 and \$860,000 in 1986-87. The \$860,000 represents 3.3% of the Utility Users Tax revenues projected for 1986-87 and is equivalent to a 0.3% tax rate.

TABLE 2

UTILITY USERS TAX REVENUE BY SOURCE\*  
(\$'s in 000)

	SMUD	PG&E	TELEPHONE	SUBTOTAL	LESS REBATE	TOTAL	% CHANGE
1983-84	5,549	4,182	5,504	15,235	284	14,951	--
1984-85	7,465	4,822	7,289	19,576	408	19,168	28.5%
1985-86	9,163	4,899	8,583	22,645	750	21,895	14.2
1986-87	10,640	5,546	9,560	25,746	850	24,896	13.7

\* Amounts represent cash receipts and are not adjusted for accruals.

Indexing. Any number of indicies could be applied in any number of combinations depending on what public policy goal is being targeted. For example, a common goal of indexing is to minimize constituent tax burdens due to changes outside of their control (e.g. inflation). This was the theory behind the indexing of state and federal income tax brackets which prevents taxpayers from being put into a higher tax bracket solely due to inflation. Strictly speaking, this example does not apply to the Utility Users Tax because there is only one tax rate.

To some extent overall General Fund taxes and fees in excess of cost are already indexed and capped as a result of the voter approved "Gann Limit" which adopted Article XIIIB of the State Constitution. This article limits the amount of tax proceeds which can be appropriated each year. The limit is adjusted annually based on changes in CPI and population. If the proceeds (which does include the Utility Users Tax) to be appropriated exceed the limit, the difference must be returned to the taxpayers the next year. Since 1982-83 the City has been using increasingly larger portions

of its appropriation limit (67% in 1985-86). Over the next period of years with relatively low inflation rates it is expected that more and more jurisdictions will be in a position of approaching their limit and facing the possibility of rebates. In fact, the State of California is projected to approach its limit in the coming budget year.

In the specific case of the Utility Users Tax, a goal of indexing might be to limit the growth of the revenue generated by this source to some predetermined level. From the taxpayers point of view they would at least have a limit on the amount of tax that they pay. This would predominately benefit large utility users and would compound the regressivity of the tax. From the City's point of view a limit on the growth of this revenue source would limit the overall growth of the General Fund and the City services which are provided from that source.

If for example, it is assumed that the revenue from the Utility Users Tax be allowed to grow only at the rate of inflation, then the services which are provided from this source would be able to continue at the current level, but any increased level of service would have to be paid for out of another source. Therefore, a smaller revenue base would have to support any increases in City services.

After reviewing a number of alternatives, staff has identified "population growth" and the "Local Government Implicit Price Deflator" as two relevant and practical indicies which could be applied to the Utility Users Tax. Population growth would be applied to take into account any increases in the number of utility customers and conversely the increased number of taxpayers for which City services must be provided. The Implicit Price Deflator as developed by the U.S. Bureau of Labor Statistics is an indicie which reflects the changes in the nominal cost of providing a fixed level of municipal services. In effect, it is a measure of the cost.

If these two indicies were used to limit the level of Utility Users Tax revenues it would also limit the level of service which could be provided with this revenue source. The following hypothetical example illustrates the point: If the Fire Department budget were fully funded from Utility Users Tax revenues, then growth of that budget would be allowed for increases in costs of existing service, and increases in population served. But, demands for increased levels of service could only be addressed after a significant amount of population growth had taken place; it could not, for example, be done in preparation of a large development. This is because the revenue growth would take place slowly so it would take a number of years to accumulate enough funds to pay the large fixed costs of adding a new fire station or even just adding another company to an existing station. The addition of new programs (such as HazMat) would probably have to be supported by another part of the General Fund revenue source. This is because the addition of these types of services are unrelated to population increases.

Table 3 below compares the level of revenues which would be generated by the Utility Users Tax with and without indexing. The indexing is based on a combination of the Local Government Implicit Price Deflation and Population Growth.

TABLE 3

UTILITY USER TAX REVENUES WITH AND WITHOUT INDEXING  
(\$'s in 000)

Revenue Projection			
	W/Indexing	W/O Indexing	Difference
1985-86	\$22,932	\$22,932	\$ -0-
1986-87	24,819	25,974	(1,155)
1987-88	26,915	28,836	(1,921)
1988-89	29,080	33,439	(4,359)
1989-90	31,505	39,005	(7,500)
1990-91	34,155	43,100	(8,945)

\* CPI and population growth indicies have been applied.

Administration. There are a number of administrative concerns of both the City and the affected utility companies which must be taken into account in any discussion regarding indexing. The City concerns center around what indicies are to be used, whether they are to be projected or adjusted for retroactively, when the rates would go into effect, and what impact annual rate changes may have on the workload of the Public Service activity. Whenever there are rate changes the volume of telephone calls coming into the City's Public Services counter increases significantly. The utility companies will be concerned with whether or not periodic indexing will impact the cost or effort involved in collecting the tax for the City, as currently they do not charge for this service. It should also be noted that the affected companies have requested 30-90 days to implement rate changes.

If it is assumed that reasonable indicies can be identified, a decision must still be made as to whether or not a projection of these indicies will be used (and if so, who's projection) or whether only actual indicies will be used and applied retroactively. For instance, the population growth for the prior year could be used to determine the population index for the next year.

The advantage of using a projection is that it can take into account forecast information which should better reflect the real changes which will take place in the budget year. The disadvantage is that there will have to be adjustments made each year to compensate for any variances between actual and projected.

**CONCLUSION**

Indexing the Utility Users Tax is appropriate if it is assumed that the current level of General Funded services provided by the City is at an acceptable level. If an increased level of services is appropriate, then the City must have access to revenues with real growth potential. In addition, if the City is to minimize the impact of economic cycles on its

ability to provide services, then it is prudent to maximize the potential of those General Fund revenues which do not fluctuate significantly with the economy, and in particular with the construction sector.

**RECOMMENDATION**

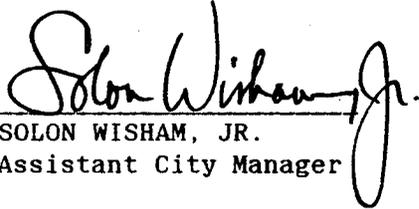
Due to the potential adverse effects that specifically indexing the Utility Users Tax could have on the City's ability to provide adequate levels of service, staff recommends that the tax rate continue to be applied in the same manner it is at this time. General Fund tax levels will continue to be constrained by the limits mandated by Article XIIIB of the State Constitution.

Respectfully submitted,



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RECOMMENDATION APPROVED:



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