2007 Municipal Tax Review Committee Report

Piedmont, California
October 1, 2007

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City Council
City of Piedmont

Dear Council Members,

It is with great pleasure that we submit the 2007 Municipal Tax Review Committee Report for your review. We want to thank City staff members for their time and cooperation. Their competency and hard work gave us confidence that day-to-day City management is in good hands.

We thank the City Council for placing its trust in us and for their careful consideration of our report and recommendations. The Committee members have all enjoyed their participation in this most important review process and have an appreciation of the diverse talents of each member.

Unanimously submitted,

Martha Jones
Chair

Kate Breen

Brian Cain

Cynthia Kroll

Conna McCarthy

Acknowledgments

The 2007 Municipal Tax Review Committee would like to thank City staff members for their time and cooperation. City Administrator Geoff Grote, Finance Director Mark Bichsel, City Clerk Ann Swift, Administrative Services Technician John Tulloch, Administrative Technician Stacy Thorn and Director of Public Works Larry Rosenberg have graciously provided the Committee with all information requested. We would like to thank them for attending numerous committee meetings, mostly held at night. Their extensive knowledge, input and insights have been invaluable.

Committee members would also like to thank John Karnay and Nancy Lehrkind of the Grubb Company for providing information to the Committee on real estate trends in Piedmont. Michael Coleman, a consultant for the California League of Cities and the California Society of Municipal Finance Officers, provided the Committee with data comparing revenues, expenditures and general fund reserve percentages across cities.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

In March 2007, the City Council appointed five residents to the 2007 Municipal Tax Review Committee. The Committee's formal assignments were to:

- Examine the need for continuing the Municipal Services Tax (referred to in this document as the "parcel" tax) and at what rate.
- Examine whether future parcel tax levies should be based on the capital needs of the City, rather than on the condition of the General Fund.
- Examine the General Fund Reserve.
- Examine the City's Municipal Sewer Tax. In 2005, the City met the State Water Control Resources Board's mandated requirement of rehabilitating nine of Piedmont's 21 sub-basins. In 2006, the City Council voted to rehabilitate the next four sub-basins. The question addressed by this Committee is at what rate the sewer tax (which is permanent and does not need to be voted on by the electorate) should continue to be levied and whether the remaining eight sub-basins should be upgraded.
- Examine the City's Business License Tax.
- Examine the feasibility of amending the City's Charter to allow for the preparation of a three- or five-year budget plan/process. (Due to a lack of time and resources, the Committee did not pursue this project.)

On the revenue side, two favorable developments have taken place since the current parcel tax (Measure W) was approved in 2004 by 80% of the voters: property-related revenues, especially transfer taxes, have markedly increased and state takeaways have decreased. Starting in FY 05/06, Piedmont enjoyed such a boom in transfer tax revenues that the City Council did not levy the full amount of the authorized Measure W parcel tax. For FY 07/08, the City Council voted not to levy any of the nearly $1.5 million in authorized parcel tax revenues. Concerning state takeaways, in November 2004 the voters of California approved Proposition 1A, an amendment to the California state constitution intended to restore predictability and stability to local government budgets. As a result, the state is much less likely to shift more property taxes away from the City of Piedmont in the near future.

Although the City has recently enjoyed higher-than-expected revenues, the current slowdown in the real estate market is likely to slow the rate of growth of property valuations and may reduce the absolute level of transfer tax received for one or more years. The National Association of Realtors has reported that sales of existing homes hit a five-year low in August 2007, battered by turmoil in credit markets. Many analysts believe that sales and prices will fall further as the housing market receives additional blows from rising default rates that are dumping more homes on an already glutted market and causing lenders to tighten standards. These factors have made it harder for potential borrowers to qualify for loans. The Federal Reserve responded to fears that all the problems in housing and credit markets could cause a recession by cutting a key interest rate by a bigger-than-expected half point. The current credit crunch has had a significant impact on the availability and interest rate levels for so-called jumbo mortgages, loans above $417,000.[i] The question is to what extent will national trends affect the real estate market in Piedmont?

On the expenditure side, significant increases in city operating costs are more than likely in the near future, including:

1. The renegotiation of salary contracts for safety and miscellaneous personnel (current contracts end December 2007). The implementation of an improved (and more costly) pension plan for safety personnel in January 2008. This pension plan was negotiated and approved several years ago;
2. The possibility that the City might become responsible for operating the town pool within the next five years, which would likely result in annual net expenditures of about $250,000; and,
3. Increased costs for Oakland library services. The current 10-year contract ends in June 2008.

This report assumes that both the Council and the citizens of Piedmont want to maintain, at a minimum, the current level of municipal services. A second major assumption is that revenue flows from the State will not change dramatically in the coming few years. The State, however, is currently facing a $5 billion deficit, which may lead it to enact emergency measures leading to a temporary "borrowing" of additional city property tax revenues in the near future.

It is important to note that although estimates of increased salary/benefits expenditures are included in the Committee's financial projections, increases for library and pool expenditures are not. Moreover, none of the projects suggested in the Civic Center Master Plan are discussed here. The report also assumes that $1 million in parcel tax will be levied by the Council in FY 08/09, the last year of the currently authorized tax.

Parcel tax committees the past 25 years have usually had to deal with difficult financial times, low reserve levels, and a parcel tax that was needed to keep the city operating at the service levels desired by the Community. This Committee faces a somewhat different situation. In the past few years, and especially FY 05/06, real estate-based property tax revenues increased way beyond what was anticipated. The Council, however, did not spend these windfalls and so the General Fund reserve started accumulating. In FY 06/07, the City exceeded its General Fund reserve limit of 25%. In response, the Council took three actions:

1. It transferred more than $5 million out of the General Fund. Most of this transfer went to the Capital Improvement Projects Fund (CIP). This large transfer was mostly used to pre-fund CIP spending for FY 07/08. CIP projects are one-time expenditures used for city beautification;
2. It cut budgeted FY 07/08 CIP spending; and,

3. It did not levy the authorized parcel tax of $1.5 million in FY 07/08, giving residents ongoing tax relief. In FY 06/07, only 57% of the authorized parcel tax was levied.

One thing is clear: if the real estate boom were to continue, and if the Council were to continue spending at current levels, a parcel tax would not be needed in the next four-year cycle. The two basic issues are: How will the real estate market develop? Are costs expected to increase significantly over the next five years?

A general discussion of the Committee's findings and recommendations follows. Each of these issues is described in more detail in the full report.

MUNICIPAL PARCEL TAX

Calculating the appropriate level of the municipal parcel tax is clearly an exercise in judgment and forecasting. The Council did not levy the authorized tax in FY 07/08, but this is not sustainable over the next five years unless myriad expected cost increases do not materialize and unless Piedmont is not affected by the real estate market downturn evident elsewhere. The Committee used three methods to estimate whether a tax is needed and what the level of the parcel tax should be:

Method #1: The Committee ran a series of parcel tax option scenarios, each using three different assumptions for the economic climate and strength of the real estate market (optimistic, middle, pessimistic). The options were:

1. No Parcel Tax
2. The current level of authorized parcel tax ($1.5 million) with a trigger mechanism to reduce the tax in case of very strong property-based tax revenues. This option is called the "$1.5 million/$1.0 million/$0" parcel tax, because the parcel tax would be reduced if transfer taxes exceed certain trigger levels.
3. A $1 million parcel tax.

Method #2: City Administrator Geoff Grote suggested that the tax should be calculated based on the City's capital needs rather than on the condition of the General Fund. The City would calculate "capital needs" as the amount transferred out to the Capital Improvements Fund in recent years. This would result in a tax of about $800,000 to $1 million.

Method #3: Former Council member Jeff Wieler submitted a proposal to the Council in 2005 that would use the amount of state takeaways (local property tax money diverted by the State to pay for its General Fund K-12 education expenditures) as a basis for the parcel tax amount. Using current levels of state takeaways, this parcel tax would be about $1.1 million.

Note that for any parcel tax amount, the Council could choose to include language in the ballot measure that reduces the parcel tax if a certain reserve limit is exceeded. For the current Measure W parcel tax, that trigger is a reserve limit of 25% (calculated as the ending fund balance as a percentage of operating expenditures).

The Committee recommends that the Council reauthorize the parcel tax at the current $1.5 million level, with the triggers included in the $1.5 million/$1 million/$0 scenario. The analysis shows that revenues are uncertain--The difference between a strong and weak property market could amount to $2 to $4.5 million annually during the parcel tax period. Summary comments follow for each level of parcel tax considered:

No Parcel Tax after FY 08/09:

- With no parcel tax after FY 08/09 and a strong real estate market, city reserves would be between 19% and 33% of expenditures.
- With no parcel tax and a weak property market, Piedmont would exhaust its reserves by FY 10/11. Were it possible to continue deficit spending (which it could not) the city would be $6 million in the red in FY 12/13, or lacking 27.5% of expected expenditures.
- With no parcel tax and a moderate real estate market, the city is left with a General Fund reserve of about 3% in both FY 11/12 and FY 12/13, assuming a $1 million parcel tax is levied in FY 08/09.
- No parcel tax means the city would be deficit spending (i.e. expenditures exceeding revenues) every year with a weak real estate market; in three of the four years with a moderate market; and in one year even in the strong market.

$1.5 Million/ $1 Million/ $0 parcel tax:

- A $1.5M/$1M/$0 parcel tax would allow the city to maintain the current level of services in the optimistic or moderate real estate market scenarios.
- The pessimistic scenario leaves the city with a 1% reserve in FY 12/13. Even with a $1.5M/$1M/$0 parcel tax, some type of reductions in planned expenditures would be needed to give the city an adequate General Fund reserve.

$1 million parcel tax

- A $1 million parcel tax would also allow a positive ending fund balance for strong or moderate real estate markets, but the weak real estate market would leave the city budget with an inadequately low reserve in FY 10/11, growing to a negative ending fund balance of 8.5% of expenditures by FY 12/13.
- Much tighter constraints on salary growth, as well as capital expenditure reductions, would be required to make it possible to maintain current service levels with a $1million parcel tax and a weak real estate market.

In summary:

- The decision to eliminate the parcel tax could lead to serious economic difficulties in a weak real estate market and to very tight budget conditions in a moderate market.
- In a weak real estate market, a $1 million parcel tax would require the city to make significant cuts in capital and operating expenditures to avoid a deficit. The reserve would still be inadequate.

- A $1.5M/$1M/$0 parcel tax would give the city the resources to provide services at the current level in a wide range of real estate markets, while providing some restraint on parcel tax assessment levels if real estate market conditions are strong.
- These scenarios assume that a $1.0 million parcel tax is levied in FY 08/09. If the City assumes operation of the pool within the next year, the Council should consider levying a $1.5 million parcel tax in FY 08/09.
- We recommend that the Council place a parcel tax authorization of $1.5 million on the ballot, with a tiered structure such as that described here and the ability to restore some parcel tax reductions in the event of an additional round of emergency ERAF takeaways.
- Finally, some words of caution: Unless the Council is prepared to explicitly state that it will not underwrite the costs of operating the swimming pool, any long-term financial decisions based on this report should have these operational costs added back in. Otherwise, Piedmont is highly likely to commit to levels of expenses that it will be unable to sustain, and which will rapidly exhaust reserves. Future operating expenditure increases for both the pool and the library combined could amount to about $0.5 million per year**.** Moreover, the estimated salary increases used in our projections may or may not be adequate to maintain safety forces at desired levels.

BUSINESS TAXES

Business taxes provide the City with a source of revenue that diversifies its tax base: business taxes are not property-based. The Committee does not recommend changes to the basic tax rate of $2 in tax per $1,000 in gross receipts, but does recommend adding a small business rate to the tax structure for home-based businesses. Currently, the minimum tax is $100, but some residents with specific occupations are charged only $50 for low levels of gross receipts. The Committee recommends that all residents with home-based businesses and gross receipts less than $2,500 be exempt from the business tax. The City would need to verify the level of gross receipts from any resident applying for the exemption.

GENERAL FUND RESERVE

Piedmont's General Fund reserve limit sets a maximum reserve relative to the City's operating expenditures of 25%. The reserve limit is specified in the City Charter and was raised from 10% to 25% by the voters in 2000. The Committee does not believe that a General Fund reserve policy that resides in the Charter and is cumbersome to change (because it can only be adjusted with a vote of the electorate) is the best way for the Council to manage the reserve. The Council should discuss the reserve policy every year during the budget process and make recommendations. This would give the City needed flexibility. Moreover, the Council currently only specifies a maximum reserve percentage. It would be desirable for the Council to also specify a minimum reserve percentage and/or a desired target reserve percentage.

Currently, a trigger mechanism connects the City's reserve maximum cap of 25% and the parcel tax: If the reserve percentage of 25% is exceeded, the parcel tax levied must be reduced to bring down the reserve level under the cap. It is important to understand, however, that this trigger is specified in the parcel tax ballot language and not in the Charter. The Council can retain this type of trigger in future parcel tax measures and still take the reserve maximum percentage out of the Charter. In cases where the reserve cap is exceeded, the City can also reduce it by increased spending on one-time capital improvements (and not create on-going spending commitments with windfall revenues).

The Charter specifies the way the reserve percentage should be calculated, but the parcel tax language uses a different method. It is the method specified in the parcel tax that the City uses to actually calculate the reserve, not the method specified in the Charter.

The Committee reviewed several surveys of General Fund reserve policies in more than 100 cities obtained from the California Society of Municipal Finance Officers. The Committee learned that:

- There are many different ways to calculate reserve minimum and maximum percentages.
- Most cities surveyed did not have a reserve cap (maximum reserve percentage). Even fewer had a binding cap (e.g., a requirement to reduce General Fund spending or transfer funds out of the General Fund if the cap were exceeded).
- Piedmont's 25% maximum cap is low relative to most other cities that have a cap. Most cities' caps were about 50%.
- Most cities surveyed did have a minimum reserve percentage and/or a desired target minimum reserve percentage. For many cities, this minimum is in the same range as, or higher than, Piedmont's maximum of 25%.
- The Government Finance Officers Association recommends a *minimum* reserve percentage of about 15% for a city like Piedmont (with a small population and narrow revenue base). With Piedmont's maximum at 25%, this does not allow the City much flexibility.
- Piedmont is a relatively small city. Expressing the reserve cap as a percentage, and not taking into account the level of the reserve, could lead to problems. If an emergency were to arise that required a certain amount of funds, that amount could easily be large relative to remaining reserves.
- Most California cities do not have their reserve policy in their charter. Only about 25% of California cities have charters; most are general law cities. Among charter cities surveyed, only Glendale had a maximum cap for the reserve in its charter.

If Piedmont's reserve percentage cap were under review on an annual basis, the Council could discuss issues such as the level of the cap and the way it is calculated in the context of its budget deliberations. The Council could also implement a reserve minimum, perhaps on the order of 10% to 15%. An ongoing discussion about a maximum, minimum or desired target would serve the interests of the City better than a reserve policy specified in the Charter. Taking the reserve cap out of the Charter would not prevent the Council from including a reserve percentage as a trigger mechanism for the parcel tax.

MUNICIPAL SEWER TAX

The Committee's process of evaluating the sewers found that:

- As of 2005, the City has been in compliance with the sewer repairs required by the State and has rehabilitated 54% of its original clay pipe sewer lines.
- Money is available on very favorable terms for sewer repair from the State. It would be a good idea to take advantage of this funding while it lasts. The City applied for a state grant in March 2007 and is still waiting for a response.
- In 2006, the Council authorized the rehabilitation of an additional 13% of the lines. As soon as the City hears whether its grant application has been accepted by the state, the City is ready to put the project out to bid. Two factors, state funding and the bidding climate, are the unknowns at this point.
- The City is currently undertaking camera explorations (TV video) to determine the condition of the remaining 33% of the lines. This process is expected to be completed by early 2008. Preliminary findings indicate that the City should continue with a plan to replace all remaining sewer lines. The camera inspection process has been delayed because of the poor condition of the pipes. In particular, collapsed pipes have slowed down the video camera inspection and have necessitated numerous repairs.
- No voter action is required to continue levying the sewer tax. Piedmont's current sewer tax rate was passed in 2000 by 76% of the voters.
- It is a certainty that new, unfunded requirements for maintenance and storm drain collection systems will be mandated on all East Bay cities by the federal EPA, the state EPA and the State Water Resources Control Board. This should be taken into consideration in setting the future sewer tax rate and in deciding how many additional sewer miles to rehabilitate.
- Ongoing annual operating maintenance costs for sewers will continue to increase as mandated by outside governmental agencies. This includes rodding and foaming of all sewer lines on a predetermined schedule (25% of the system every year). Rodding is much cheaper than foaming, but rodding can only be done on rehabilitated, plastic pipes.
- Completion of the sewer rehabilitation project will promote equity among residents: all taxpayers have been paying sewer taxes, all original clay pipes are in need of replacement, and no one wants the sewers in their neighborhood to be the ones not upgraded.
- Rehabilitating our aging sewer infrastructure will reduce City liability, to the benefit of all residents.

In summary, given the age and poor condition of the remaining portions of the City's sewer system, favorable financing from the State and escalating construction costs, the Committee agrees that it would be wise to complete the work as quickly as possible. Unless the TV video camera inspection process (which is ongoing and expected to be completed in early 2008) gives evidence to the contrary, the Committee recommends levying the full sewer tax, including the inflation adjustment, and rehabilitating all sewer lines in Piedmont.

COMMITTEE RECOMMENDATIONS

Recommendation #1: The Committee recommends adding a small business rate to the tax structure for home-based businesses. Currently, the minimum tax is $100, but some residents with specific occupations are only charged $50 for low levels of gross receipts. The Committee recommends that all residents with home-based businesses and gross receipts less than $2,500 be exempt from the business tax. The City would need to verify the level of gross receipts from any resident applying for the exemption.

Recommendation #2: The Council should review the City's General Fund reserves on an annual basis and establish minimum reserve limits or maximum reserve limits, as necessary, as part of the overall financial planning process, thereby facilitating immediate responses to unfavorable or favorable fiscal trends as they arise. To implement this recommendation, the Council should approve a ballot measure to be voted upon at the next municipal election to remove the reserve percentage cap from the City Charter. Instead the ballot measure would authorize the Council to establish minimum reserve limits or maximum reserve limits, as necessary, by resolution of the Council or by an ordinance.

Recommendation #3: According to the Committee's projections of expected costs and revenues, the City will need a parcel tax to maintain the current level of municipal services. The Council should renew the current level of the authorized parcel tax ($1.5 million), with an added a trigger mechanism to reduce the tax in case of strong property-based tax revenues. This is called the "$1.5 million/$1.0 million/$0" parcel tax, because the tax would be reduced if transfer tax revenues exceed certain trigger levels. The tax would have a tiered structure and the ability to restore some parcel tax reductions in the event of an additional round of emergency ERAF takeaways

Recommendation #4: The City should plan to rehabilitate all the old clay sewer pipes in Piedmont. This would involve levying the Sewer Tax at the maximum rate for the next five years, including inflation adjustment, and pursuing state financing.

Recommendation #5: In 2011, a Municipal Tax Review Committee should be appointed by the Council to review both the Parcel Tax and the Sewer Tax, and to make recommendations to the Council. We recommend that the Council appoint at least seven members to this Committee, that the review process start in January 2011, and that the Council provide some resources to the Committee for the report to be written. This might include clerical support from City staff or, alternatively, hiring a consultant.

2007 Municipal Tax Review Committee Report

INTRODUCTION: PARCEL TAX BACKGROUND

Piedmont's parcel tax is a general tax. It is not targeted to pay for specific services and is available to fund general government operations. Revenues go directly into the General Fund, which pays for city services such as police, fire, ambulance, recreational programs and facilities, street repairs, and parks. Parcel tax measures in Piedmont have been voted on every four years since 1980 and seven such taxes have been approved by the voters. In the March 2004 election, one parcel tax proposal did not receive the required two-thirds majority (Measures S and T), but a reduced tax amount did pass in November 2004 (Measure W). How much is levied for a Piedmont's parcel tax? A comparison of the rate structure for various levels of revenues is in Table 2. For FY 07/08, parcel tax rates and revenues are zero.

Table 1

Election	**March 2000**	**March 2004**	**November 2004**
Name of measure	Measure G	Measures S and T	Measure W
Dates tax in effect	7/1/01 – 6/30/05	NA	7/1/05 – 6/30/09
Maximum amount	$873,934*	S: $1,800,000 * T: $300,000 *	$1,406,425*
Vote Percentage	70%	S: 62% T: 60%	80%

*The maximum is indexed for inflation in subsequent years using the San Francisco Bay Area CPI.

Table 2

Parcel Tax Rate Structure for Three Levels of Parcel Tax Revenue: $0.7 Million, $1.0 Million and $1.5 Million

	Number	**Parcel Tax Revenue,** $ millions		
Single Family Residence	**Parcels**	**$0.7M**	**$1.0M**	**$1.5M**
0 to 4,999 sq. ft	1,008	$160	$228	$342
5,000 to 9,999 sq. ft	1,955	$178	$255	$382
10,000 to 14,999 sq. ft	503	$207	$296	$444
15,000 to 20,000 sq. ft	152	$236	$337	$505
Over 20,000 sq. ft	168	$269	$384	$576
Commercial Properties				
0 to 10,000 sq ft	7	$269	$384	$576
Over 10,000 sq ft	6	$403	$575	$863
Multi-Family Residential (per unit)*	37	$111	$158	$237
Dual Jurisdiction (per parcel)	2	$163	$233	$350
Total number parcels**	3,838			
Average per parcel**		$183	$262	$393

* Multi-family residential parcel taxes are collected per unit, not per parcel.

** The number of parcels varies slightly from year to year. An additional 141 parcels are exempt.

In the past 10 years, the Council has chosen to levy less than the authorized amount more often than not. Chart 1 shows the relationship between the amount authorized and the amount levied. From FY 92/93 through FY 97/98, the Council levied almost the full amount of the tax, but starting in FY 98/99, the Council has chosen to levy the entire authorized amount of the parcel tax in only four years (FYs 01/02, 02/03, 03/04, 04/05). From FY 98/99 through FY 00/01, and again in FY 05/06, the Council levied about 75% of the authorized parcel tax amount. In FY 06/07, this percentage dropped to 57%; in FY 07/08, no parcel tax is being levied. On an inflation-adjusted basis, parcel tax revenues are substantially lower now than in the 1980s and early 1990s. Chart 2 shows actual and inflation-adjusted parcel tax revenues since FY 81/82.

Chart 1

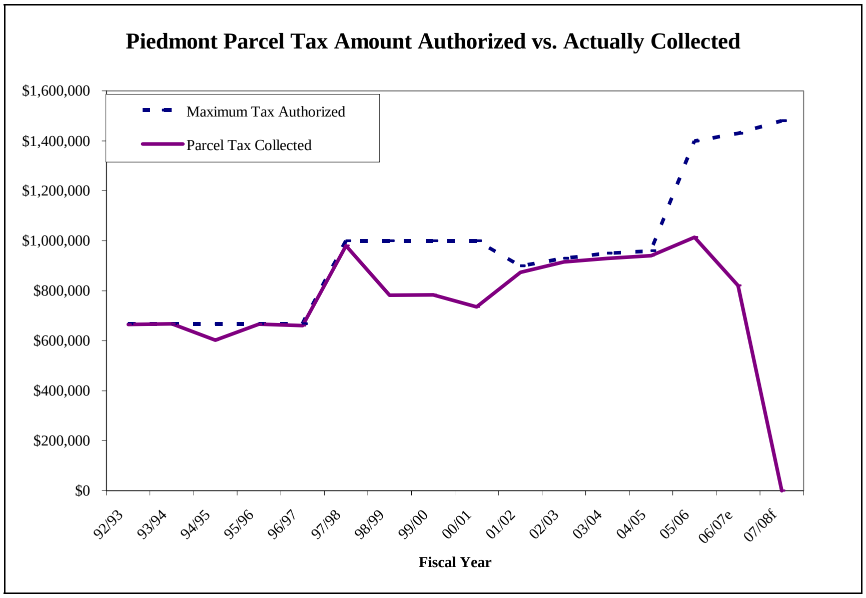
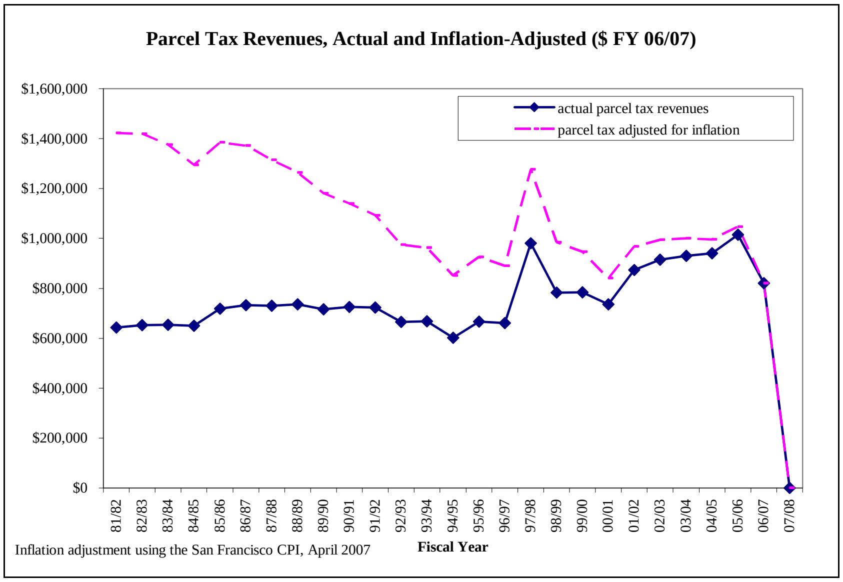


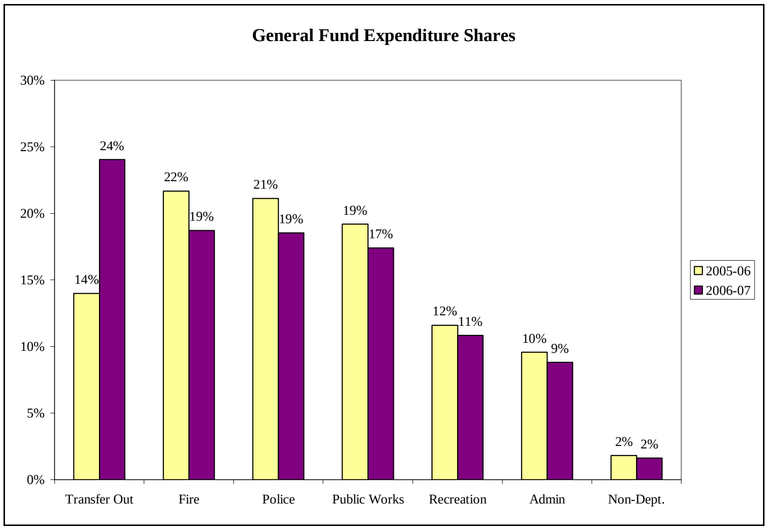
Chart 2



OPERATING EXPENDITURES

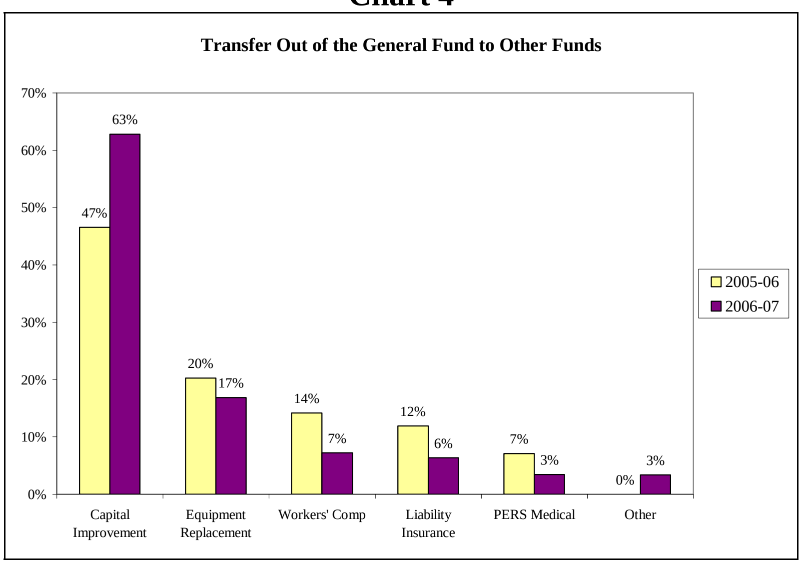
The bulk of Piedmont's General Fund operating expenditures are for salaries and benefits (about 70%). Shares for operating expenditures by department and transfers out are shown in Chart 3 for FY 05/06 and FY 06/07. The increase in the percentage of the budget "transferred out" went from 14% to 24% across these two fiscal years.

Chart 3



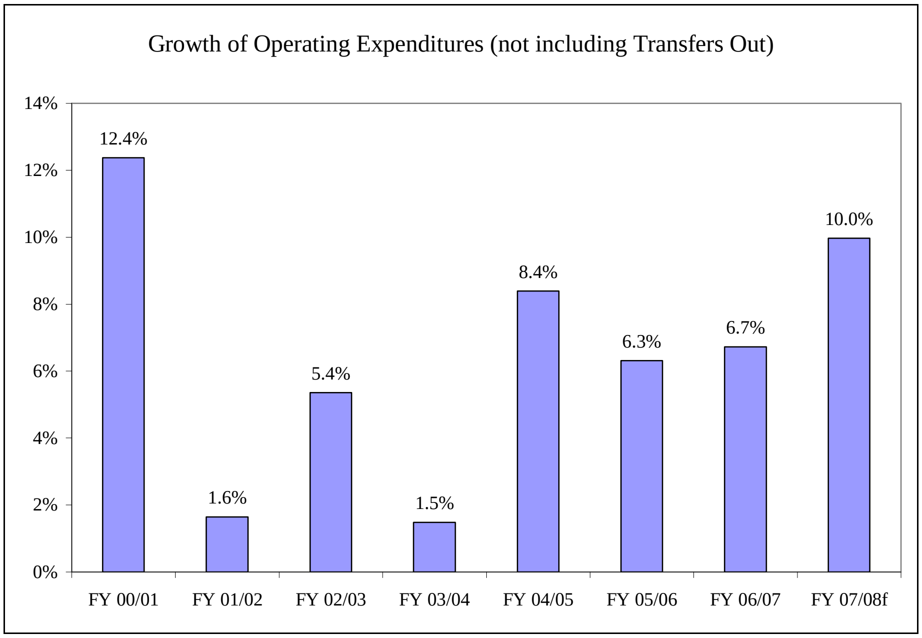
Details of the funds transferred out show that most of the money went to CIP: the share of CIP funds increased from 47% in FY 05/06 to 63% in FY 06/07. These funds are used for City beautification projects.

Chart 4



To decide whether a parcel tax is needed from FY 09/10 through FY 12/13, scenarios were created for future revenues and expenditures. Budgeted operating expenditures for FY 07/08 are about $17.8 million, with an additional $1.7 million to be transferred out. Chart 5 shows that historical annual increases in General Fund operating expenditures (excluding transfers) have been between 2% and 12% .

Chart 5



How does the Committee expect expenditures to change over the next five years? Increased operating costs are likely in the near future, including:

1. The renegotiation of salary contracts for safety and miscellaneous personnel (current contracts end December 2007). Safety personnel have received salary increases based on the Consumer Price Index (CPI) for the past few years, with the result that their salaries are most likely below market rates. An improved pension plan (3%-at-50) for safety personnel (which was negotiated five years ago) will be implemented in January 2008;
2. The possibility that the City might become responsible for operation of the town pool within the next five years, which would likely result in annual net operating costs of about $250,000; and,
3. Increased costs for contracting with the City of Oakland for library services. The current 10-year contract with the Oakland Public Library ends in June 2008.
4. Increased personnel costs in Administration. In 2006, an IT position was added to the administrative staff. One result of this increased IT staffing will be a new, improved city website, expected to go live in October 2007. In 2007, the part-time position of Station Manager for KCOM was made full-time. The Station Manager will work on upgrading the KCOM station equipment to digital format. As a result, the City will be able to provide on-line web-casts of public meetings.

One cost decrease might be on the horizon: Operating costs are likely to drop slightly if changes in Piedmont's election timing are implemented. Discussions are under way to possibly change municipal and school-related elections to November instead of March.

Another potential cost to the City concerns Piedmont's participation in the Regional Housing Needs Allocation (RHNA) process. This is a state-mandated program intended to ensure that all jurisdictions do their "fair share" to accommodate affordable housing. State law requires each city and county to use the RHNA numbers as the foundation for their Housing Elements, the chapter of the general plan addressing affordable housing and other housing issues. Failure to have a state-certified Housing Element has a number of financial and legal consequences, including the potential loss of state funds. Piedmont's 2002 Housing Element was fully certified in 2003, but must be re-certified in 2009 based on new RHNA numbers recently released by the Association of Bay Area Governments (ABAG). Piedmont's new RHNA assignment will make it very difficult for the City of Piedmont to develop a compliant Housing Element in 2009. The City's low/very low income housing assignment for 2007-2014 has increased 130% compared to the 1999-2006 assignment. In fact, Piedmont's "low/very low" share of new units as assigned by the RHNA, at 58%, is the highest share for any city in the Bay Area. The City Administrator has submitted a letter to ABAG objecting to the proposed RHNA income allocation, which uses a methodology that targets affluent cities.[2]

It is important to understand that future cost changes for the library, pool, election timing and the housing element have not been factored into the parcel tax analysis.

SALARY NEGOTIATIONS AND PENSION PLAN IMPROVEMENTS

The Committee believes that Piedmont residents want autonomous police and fire departments. The City has maintained an independent police force and fire department since 1907. The Committee has not analyzed current staffing levels or tried to determine the cost efficiency of police and fire operations in detail.

Concerning numbers of personnel, the FY 07/08 Budget notes that 12 of the current 18 sworn police officers, including all but one staff member, would be eligible for retirement within five years. Planning for recruiting, retention and education is important. A second police captain was hired to fill an existing vacancy in November 2006.

Since one justification for a parcel tax is to cover increased costs of labor contracts, health care and retirement contributions for public safety employees, the Committee discussed whether the measure should be advanced as a "public safety tax." This would be a specific tax, with the proceeds allowed to be spent only on public safety. The Committee agreed that since an important function of the parcel tax is to provide some fiscal flexibility, advancing the measure as a specific tax would not be in the City's best interest. A discussion of the differences between general and specific parcel taxes is included in Appendix A.

Fire and police services

Piedmont's excellent police and fire services are appreciated by the community. A survey of residents administered in April 2007 indicated that the percentage of residents "satisfied or very satisfied" with fire/emergency medical services was 98% and for police services, 96%. About 30% of households in the community responded to this survey. The Police Department has an on-going Community Policing program and the Fire Department has started a new Community Emergency Preparedness program. According to Captain Hunt, the average response time for the Piedmont police is two minutes.

Table 3

Services Performed by Piedmont Police Department		
	2005	2006
Total Calls for Service	10,026	10,038
Case Files Opened	887	944
Serious Offenses	326	328
Auto Accidents	79	93
Citations Issued: Moving violations	1,997	2,056
Citations Issued: Parking Citations	2,741	865*
Source: 2007-08 City of Piedmont Budget *The City was without a parking enforcement officer for six months in 2006. Parking enforcement personnel were also assigned to crossing guard duties in 2006.		

The Piedmont Fire Department responds to medical emergencies, fires and utility calls. One reason that many older residents remain in Piedmont rather than move to retirement communities is because of the excellent emergency medical services provided by the Department's paramedics. Piedmont has a permanent, supplemental parcel tax for paramedic services of about $18 per parcel. In 2005 and 2006, the Fire Department responded to about 675 medical emergencies a year—almost two per day. In comparison, the Department responded to 365 "fire and utility calls" per year over the same period, about one per day. There were 10 fires in 2005 and 11 in 2006. These weren't house fires, but were fires in garbage cans, cars, etc.

Table 4

Services Performed by Piedmont Fire Department				
	Medical Emergencies	**Utility Calls**	**Fire Calls**	**Total**
2005	644	351	10	1,005
2006	697	358	11	1,066
Total	1,341	709	21	2,071
Source: City of Piedmont.				

Improved Pension Agreement in 2008 for Public Safety Employees

A little more than five years ago, in an effort to better recruit and retain safety officers, the City reached a Memorandum of Understanding (MOU) 2002-2007 with union representatives of police and fire personnel. Among the items agreed upon were increases in levels of both employee pay and pensions provided to the City's safety personnel through CalPERS.

For many years, the City's safety personnel had been covered under the 2%-at-50 plan. In this plan, employees who reach age 50 and subsequently retire receive a pension benefit equal to 2% of their final pay with the City for each year they have worked. That program was the standard for public safety members throughout California until 2000, when legislation was passed authorizing CalPERS to offer cities the 3%-at-50 program and the 3%-at-55 program for public safety members. CalPERS is now authorized to offer a variety of retirement plans for municipal safety and miscellaneous employees. Table 5 shows the different retirement plans authorized by CalPERS as of October 1, 2006, and the approximate number of agencies (cities, counties, public utility districts, etc.) offering each plan.

Table 5

Number of Agencies Offering CalPERS Benefit Plans, as of October 1, 2006

	# Agencies	%		# Agencies	%
Miscellaneous (non-safety)			Safety*		
3%-at-60	84	5%	3%-at-55	117	25%
2%-at-60	212	13%	3%-at-50	352	75%
2.7%-at-55	194	12%	*Total*	*469*	*100%*
2.5%-at-55	125	8%			
2%-at-55	969	61%			
Total	*1,584*	*100%*			

Source: CalPERS. http://www.calpers.ca.gov
* Safety does not always mean both police and fire. Safety can mean just police or just fire if the agency has only police or only fire in their safety plan.

For safety employees, the 3%-at-50 plan has quickly become the standard around the Bay Area and across the State of California. Public safety employees of Contra Costa and Alameda counties are also offered the 3%-at-50 plan. For miscellaneous members, CalPERS provides the benefit formula of 2%-at-60 unless their agency has contracted for a different benefit formula.

Starting January 1, 2004, Piedmont chose to offer its miscellaneous employees the 3%-at-60 program instead of the 2%-at-60 plan. For safety employees, the 2002-2007 MOU offered the 3%-at-55 plan starting January 1, 2004, with an upgrade to the 3%-at-50 plan starting January 1, 2008. Concerning salaries, safety personnel agreed to a 5% increase in the first year, 2% in the second year and then increases according to the CPI for the remaining three years (through 2007).

For police and fire, the City will conduct a salary survey across comparable cities in early 2008 when salary negotiations begin. Because Piedmont safety workers have had raises only in line with the CPI, their salaries are probably below market level. An entry-level police officer in Oakland, for example, earns an annual salary of $69,162 to $87,172 in 2007. In Piedmont, a comparable officer would earn about $62,000 to $75,000. Police departments around the Bay

Area have been competing for qualified applicants and some are offering signing bonuses. Possibly because of the number of soldiers serving in Iraq, there seems to be a shortage of new hires for safety personnel, especially police, in this area.

One issue discussed by Committee members was the percentage of PERS contributions (both employee and employer) that are paid by the employee. In Piedmont, safety employees have paid none of the employer rate and have paid (and continue to pay) the entire 9% employee rate. The current contract does have a trigger for employees to pay part of the employer rate when it is above 37%. Regarding miscellaneous employees, the City of Piedmont currently pays the employer rate of 20% and the employee rate of 8%. The current contract does have a trigger for miscellaneous employees to pay part of the employer rate when it is above 24.4%. Mark Bichsel, City Finance Director, provided the Committee with data showing that Piedmont's current contribution rate structure is not uncommon in surrounding cities. The Committee raised the question of whether changing the employee share of contributions could result in cost savings for the City. These formulas are very complex and would need to be analyzed in the larger context of any contract negotiations.

The Committee ran scenarios using several different assumptions for percentage increases in salaries and PERS benefits for safety and miscellaneous employees. According to our calculations, each additional percentage increase in salaries and benefits would cost the City from $100,000 to $150,000 per year.

SWIMMING POOL

If the City were to take over operation of the swimming pool sometime in the next five years, what would be the operating expense implications? Should the municipal parcel tax be used to fund pool operations or capital costs?

As of September 2007, the City is obligated to take over operations of the swimming pool on July 1, 2008. Negotiations are under way to extend the lease with the Piedmont Swim Club for another 18 months, until December 2009. What will happen after December 2009 is uncertain; According to City Administrator Geoff Grote, it cannot be said that the City is likely to take over the pool.

In 2006, the City of Piedmont retained the Sports Management Group to perform an economic analysis of the probable cost of the pool operation and the revenue potential for the Piedmont Aquatic Facility should the City assume its operation. The facility is currently leased to and operated by the Piedmont Swim Club. Based on the *City of Piedmont Aquatic Study-Final Report* (issued September 21, 2006), depending on various scenarios, annual operating cost estimates for the pool range from $635,000 to $741,000.

The report also estimates $50,000-$100,000 in one-time start-up costs associated with the City taking over pool operations. The report notes that public pools typically recover 40% to 60% of operating costs from fees, classes, lessons, etc. The Sports Management Group report estimates the annual revenue potential for the Piedmont Aquatic Facility under City operation at $390,000 to $657,000.

Thus, under almost any scenario, if the City of Piedmont takes over operation of the pool, it will need to identify funds to subsidize the gap between revenue and costs. The Sports Management Group estimates that operating losses would average between $111,000 and $227,000 per year, not including any one-time start-up costs. The highest estimated operating loss is $327,000 per year. According to the *Final Report*, "the operation of the existing swim center by the City of Piedmont will require an annual, on-going, and increasing operating subsidy."[3]

Consideration of the Municipal Parcel Tax as a source for pool funding

A key question considering the potential use of a future parcel tax for municipal pool operations is whether the parcel tax should fund operating or capital expenditures. Should the parcel tax be used for specific operating costs of the pool? Should consideration be given to capital costs associated with the City's pool operation?

a) Operating Costs: Since the parcel tax is not permanent, it would not be prudent to use it for "on-going, increasing" operating costs associated with the pool. If the parcel tax were not renewed, some other funding source would have to be identified.

b) Capital Costs: If the City of Piedmont assumes operation of the pool, parcel tax funds would most appropriately be directed to a depreciation or building and maintenance reserve fund. This annual set-aside would be used to fund major replacements of building systems for pools, deck and structures.

This summary does not attempt to answer the overall question of how the City of Piedmont should manage, operate or lease the pool. Rather, it suggests that relying on the municipal parcel tax for on-going pool operating costs is, at best, a temporary and insufficient funding source. If consideration is given to using the parcel tax for any aspect of the pool as a public facility, it makes more sense to direct these revenues to a building and maintenance fund. It should be noted that the cost of an entirely new pool facility, according to the *Final Report*, would be about $7 million. This would have to be funded by a bond measure, not a parcel tax.

Although the Committee did not include explicit estimates of future pool costs into the calculation of its financial scenarios, it seems reasonable to consider the possibility that the pool will be a factor increasing the city operating budget over the time period we are considering, just as the library payment would. In that sense, the scenarios include an underestimate of future City expenditures.

LIBRARY SERVICES CONTRACT WITH OAKLAND

Piedmont's current 10-year contract with the City of Oakland, which was for approximately $350,000 per year, ends in June 2008. The Oakland Public Library (OPL) system is very likely to request increased contributions from the City of Piedmont for access to library services. The current contract does not factor in Oakland's parcel tax expenditures on library services.

Oakland's library parcel tax was first approved in 1994 with a 15-year sunset date of 2009. In March 2004, voters passed a 15-year extension with a 77% yes vote.[4] This extension includes an increase in per-parcel tax rates starting in FY 04/05 of a little more than double the previous amounts. In FY 06/07, Oakland's total library expenditures were about $27 million, of which $12.6 million (or a little less than half) were raised with the library parcel tax.

Table 6

Oakland's Library Parcel Tax, Measure Q, March 2004

Unit Type:	Proposed Tax Rate in: FY 04/05	Existing Tax Rate in FY 03/04
Single Family Residential	$75.00	$36.06
Multiple Unit Residential	$51.24	$24.63
Non-Residential	$38.41	$18.47

Source: SmartVoter.org, League of Women's Voters, http://www.smartvoter.org/2004/03/02/ca/alm/meas/Q/

How do Oakland's library expenditures compare with Piedmont's? According to FY 04/05 data on library expenditures obtained from the State Controller, Oakland spent $50 per capita on library services and Piedmont spent $31.[5] What if Oakland had requested that Piedmont pay $50 per capita in FY 04/05? If Piedmont had increased library expenditures to $50 per capita, Piedmont's total operating expenditures for libraries would have had to climb from $337,337 to $550,100, an increase of about $213,000, or slightly more than 60%.

According to figures from the State Controller, on a per capita basis, Piedmont generally has spent less than the state median across cities on library services. In FY 03/04, the state median per capita spending on libraries was $36 and Piedmont spent $29.

Differences between Piedmont and Oakland usage levels and revenue sources may be taken into account in determining any change in Piedmont's library payments. Future payments are unknown; the Committee's financial projections do not take increases into account.

Potential Cost Savings: Change Municipal Election Timing

Discussions are under way concerning a change in the date of Piedmont's municipal and school district elections so they will coincide with major state elections. Stand-alone elections (such as a March election that does not coincide with a primary) cost the City more than $40,000. City elections that are consolidated with national, state and county elections cost less than $20,000. To change Piedmont's election timing, the City Charter would have to be amended, which requires a majority vote of the electorate.

CAPITAL EXPENDITURES

In his FY 07/08 Budget message, Piedmont's City Administrator Geoff Grote suggested that the amount of the parcel tax should be based on capital expenditures:

> I believe that the Municipal Tax Review Committee should be asked to consider whether future tax levies should be based on the capital needs of the City, rather than the condition of the General Fund. This idea has a twofold advantage. The City's tax would be directly related to public projects such as renovation of Coaches Playfield rather than operational expenses such as salaries and benefits. The annual levy of the tax would be directly linked to the cost of public improvements.[6]

If a parcel tax were to be based on capital expenditures, what amount should that tax be? Which capital expenditures should be included in the calculations? Should the parcel tax be tied solely to capital expenditures (i.e. a specific tax)? The Committee agreed not to pursue the idea of a specific tax because, as was previously mentioned concerning the possibility of a public safety tax, an important function of Piedmont's parcel tax is to provide the City with some fiscal flexibility. A specific tax would not fulfill this function.

Concerning the amount of the parcel tax and which capital expenditures should be considered, the Committee focused on transfers out from the General Fund (GF) for capital improvements: To identify city beautification and capital projects, the Capital Improvements Project (CIP) Committee, which is made up of volunteers from the City, draws up a list of possible capital improvement projects and then prioritizes them for the Council. The Council decides which projects are to be funded and then transfers funds from the GF to the CIP Fund to pay for them. The CIP fund can save for multi-year projects and does not have a reserve limit. The amount to be transferred to CIP is discretionary.

There are at least two complications with using historical CIP funding as a basis for the amount of the parcel tax, however. First, in FY 06/07, certain regular maintenance and repair projects (such as curbs, sidewalks and gutters) were moved from the CIP to the Building Rehabilitation/Equipment Replacement/Operation Fund. This means that the CIP fund, which previously had spent about $250,000 annually on regular maintenance, is no longer obliged to do so. In Chart 6, to make CIP funds comparable over time, the dashed line adjusts historical CIP funding from FY 99/00 to 05/06, taking out regular maintenance spending.

Second, in FY 06/07, because of substantial increases in transfer and property tax revenues, the City hit its GF reserve limit of 25%. As a result, the City made a large "transfer out" from the GF in FY 06/07 to the CIP fund, to pre-fund capital projects in FY 07/08. Chart 6 shows the actual transfer out for CIP and the average CIP funding in FY 06/07 and FY 07/08. The "adjusted CIP" line in Chart 7 combines the two adjustments described in Chart 6.

Chart 6

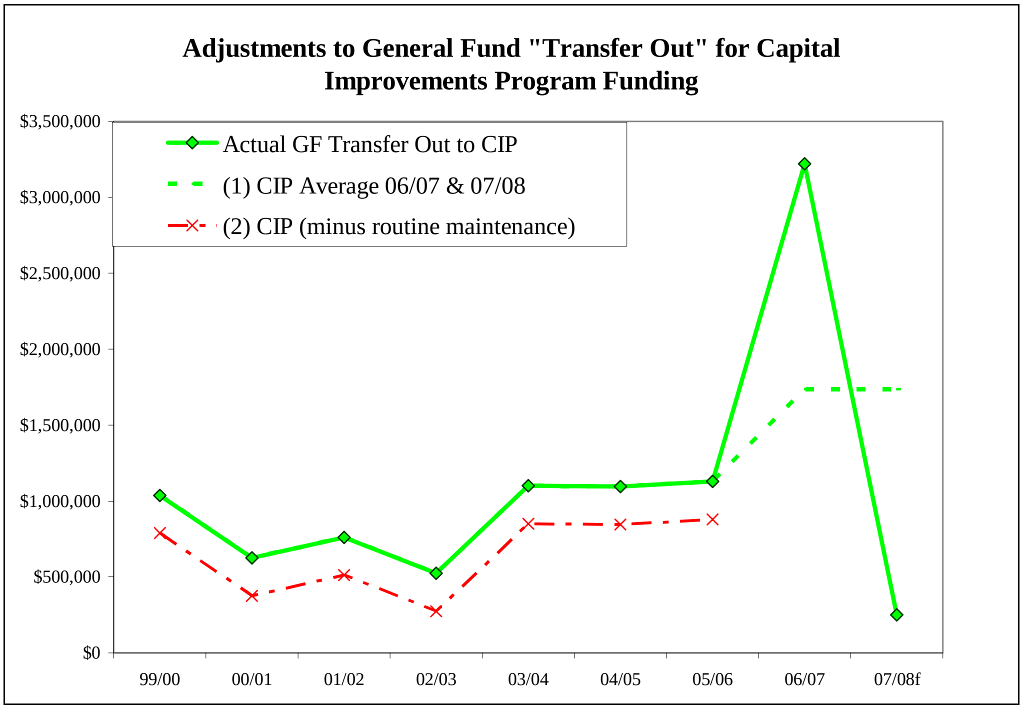
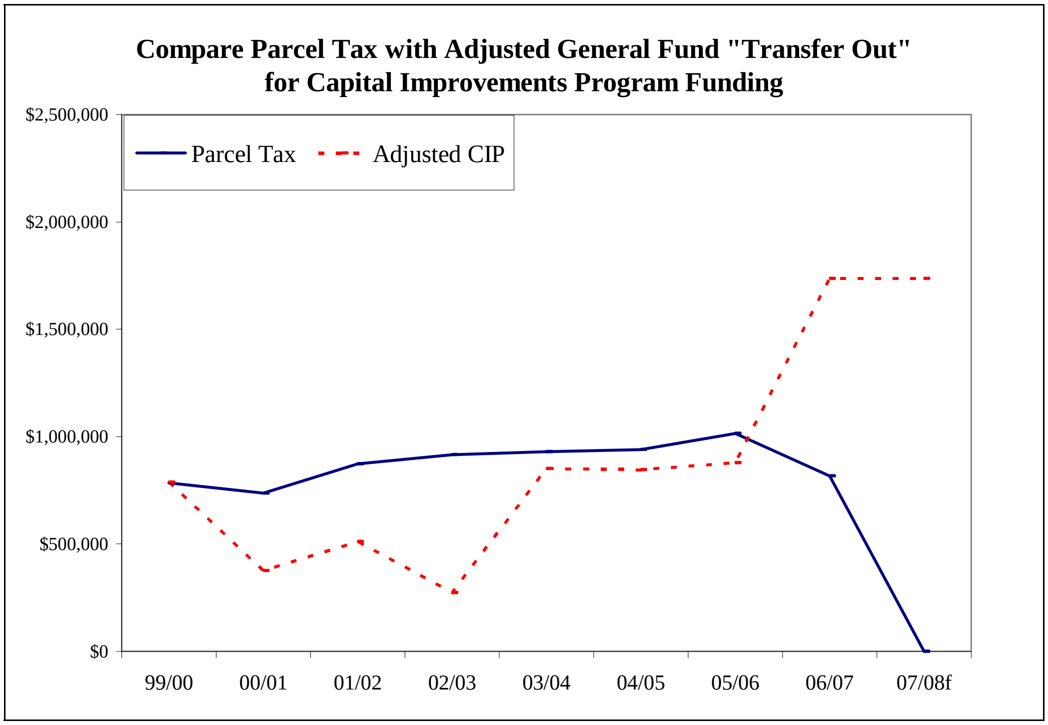


Chart 7



If a future parcel tax amount were to be based on "transfers out for CIP," how big should that tax be? After adjusting for routine maintenance expenditures and the spike in FY 06/07, Chart 7 shows that CIP funding has jumped around fairly dramatically: it fell from about $0.8 million in FY 99/00 to less than $0.5 million in FYs 00/01, 01/02 and 02/03; it increased to $0.8 million in FY 03/04, FY 04/05 and FY 05/06; and then it increased again to an average of $1.8 million in FY 06/07 and 07/08.

CIP funds are discretionary and are clearly following the financial fortunes of the City: In good times, they increase; in bad times, they are cut. **In terms of using average CIP funding as a basis for the amount of the parcel tax, the chart suggests that perhaps $800,000 to $1 million might be a good estimate.**

Table 7 below lists capital improvement projects recommended to the Council for FY 07/08. The CIP Committee recommended almost $1 million in projects, but the Budget guideline was $750,000.

Table 7

Capital Improvements Program: Recommended Projects for FY 07/08

Project Description	
Regular Maintenance	
Survey monuments	$15,000
Removal & Replacement of Liquid Ambers	$25,000
Veterans' Hall Kitchen Renovation	$60,000
St. James Entry Pillar Renovation	$7,500
Community Hall Lower Kitchen Renovation	$50,000
Guilford Tennis Court Replacement (Savings Account)	$50,000
City Hall HVAC	$150,000
Improvements	
Excedra Plaza Phase III	$147,000
Hampton Sports Field/Park Renovation	$350,000
Dracena Drainage and Turf Replacements	$70,000
Highland Way Bus Shelter	$25,000
Pedestrian Pat Signage	$10,000
Total Budget Request FY 2007/08	$959,500
2007/08 Budget Guideline	$750,000

Source: May 7, 2007 memo to the City Council from the 2007/08 Capital Improvement Projects Committee, Margaret J. Fujioka, Chairperson.

The Civic Center Master Plan

In addition to CIP funding, other major capital projects are being discussed by the City as part of the update of the 1996 General Plan. Improvements to the swimming pool, already mentioned in this report, are potentially part of a larger project: the Civic Center Master Plan. The City has begun to discuss the future of the civic center and has hired a consultant, Fisher-Friedman Associates, to develop a plan. Numerous issues have been highlighted, including:

- A swimming pool that is too small for the number of users
- Inadequate parking; traffic circulation problems
- A recreation department with inadequate facilities - the department is currently located in a non-ADA compliant house that was donated to the City years ago
- City-owned 801 Magnolia (formerly the Christian Science Church)
- Usage of the Carriage House
- Enhancement of the Police Department, City Hall, Firehouse and the Veteran's Memorial Building

The funding for these projects is not included in any of the Municipal Tax Committee's financial scenarios for parcel tax calculations. The assumption is that mechanisms other than a parcel tax, such as a municipal general obligation bond measure or private donations, for example, would be needed to fund these major projects, if approved.

A survey administered to Piedmont households in April 2007 detailed support for increasing taxes or fees for 13 specific projects (see Table 8). "Support" includes those who somewhat supported and those who strongly supported the project. "Other" includes those who were strongly opposed, somewhat opposed, had no opinion or no answer.

Table 8

Q7: For which types of projects would you support increases in city taxes or fees?

	Support	Other
Landscaping and tree planting	64.3%	35.7%
Undergrounding of overhead utility wires	62.9%	37.1%
A teen center	59.1%	40.9%
Bike paths and marked bike lanes	58.5%	41.5%
Creating a community gathering place or plaza	55.0%	45.0%
Additional recreational facilities	54.3%	45.7%
Free citywide wireless (WiFi) internet service	51.3%	48.7%
City-owned and maintained competitive-sized swimming pool	49.6%	50.4%
City arts and cultural center	48.0%	52.0%
Larger wheeled mixed materials recycling carts	44.6%	55.4%
Backyard service for recycling or green waste	43.1%	56.9%
A parking garage in the City Hall area	35.3%	64.7%
More child care centers	31.0%	69.0%

Source: City of Piedmont Council Agenda Report, 09-04-07. Summary of General Plan Resident Survey

REVENUES

BUSINESS TAXES

The Council requested that the Committee review Piedmont's business taxes. These taxes provide about $350,000 annually, or about 2% of General Fund revenue. The City collects three types of business taxes: a rental tax on both residential and commercial property; a tax on home-based businesses (home occupation permit and business license); and taxes levied on individuals or companies whose business is transient in nature. Examples of the transient tax are revenue from a contractor who works in the City for a job of fixed duration or film permit revenue for films shot in the City. The tax on home-based businesses is basically in exchange for the exemption from residential zoning. Although Piedmont is zoned primarily for single family residential living, the City allows homeowners to use a portion of their residence for certain types of offices and other home occupations. The city's rules regarding home businesses are intended to safeguard the residential quality of life in Piedmont and are available from the City Clerk.

Current business tax rates have been in effect since 1991 and cannot be increased without voter approval. First-time permit applicants must pay a flat fee. After the first year, Piedmont's business license rate is 0.2% of gross receipts ($2 per $1,000 earned). For example, if a resident with business income in Piedmont had $56,000 in gross receipts, the tax would be $56,000 X 0.002 = $112. The business license application lists several additional categories, such as a $500-a-day charge for filming and $200 per day for auctions. For most businesses, the minimum levy is $100 per year. The exceptions are (1) gardeners, chimney sweeps, pest control and craft/art with gross receipts less than $5,000, and (2) interior designers with seller's permit with gross receipts less than $3,000. For these exceptions, the minimum is $50 per year.

The Committee was not clear why some small businesses are charged different minimum rates than others: Why do gardeners, chimney sweeps, pest control and artists get a different deal than interior designers, who get a different deal than all others (e.g. someone who does a small amount of consulting)? The Committee agreed that there should be equity among small businesses: Whatever the rate is for businesses earning a small amount of gross receipts, it should be the same for all kinds of businesses. It is not good tax policy to favor certain groups over others.

Chart 8 shows the distribution of revenues across the three tax types. The estimate for FY 06/07 is based on the first nine months of the year (annualized). Transient taxes are estimated to have been somewhat lower in that year because of a drop in film permit revenue.

The average value of tax paid by home-based businesses has varied between $200 and $400 in recent years. Revenue from home occupation permits (HOP) is cyclical and lags changes in the number of permits by a year. As shown in Table 9, for example, the large increase in HOPs in FY 04/05 resulted in a $30,000 increase in revenue in FY 05/06. To the extent that the city can identify and register new home businesses, the number of permits increases and so, subsequently, do revenues. Businesses also close, however, resulting in decreases in revenue.

Chart 8

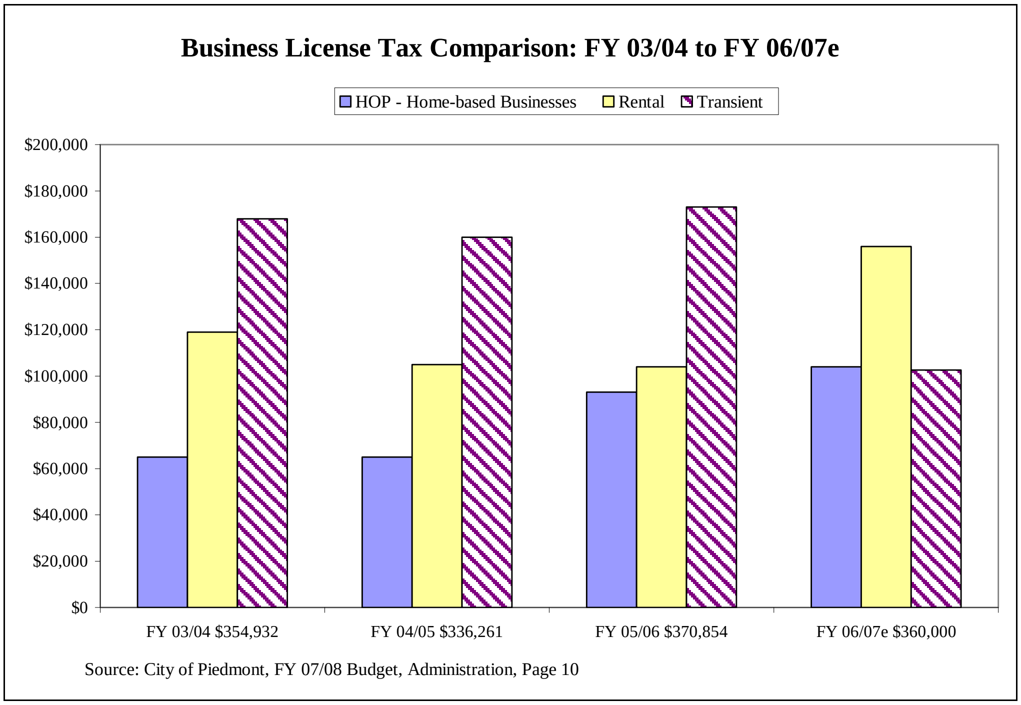


Table 9

Home-based Businesses: Business Tax Revenue Analysis			
Fiscal Year	Number of Permits	Total Revenue Gross Receipts	Average Value of Tax Paid per HOP Taxpayer
00/01	146	$29,592	$202
01/02	155	$64,732	$417
02/03	168	$58,515	$348
03/04	159	$64,605	$406
04/05	258	$66,939	$259
05/06	277	$91,306	$329
06/07 (9mos)	275	$76,220	$277
Source: *City of Piedmont FY 2007-2008 Budget*, Administration, Page 11.			

The City could improve compliance with the business license tax by:

1. Linking information between the City Clerk and the Planning Department (especially on tax revenue from contractors).
2. Standardizing software packages. The City currently uses two different software vendors for business licenses and for permitting in the Public Works and Planning Departments. The City is looking into changing to a single software vendor so there's a seamless interface between the two systems. There will be a short-run cost to mesh the systems but, in the long term, compliance with business taxes will improve.

3. Improving enforcement of the home occupation tax. The City receives information from the Franchise Tax Board on which residents have filed business income taxes. Residents who have filed business income taxes but do not have a business license are contacted by the City and advised that they might have a business tax liability.
4. Improving rental tax collection. A new Piedmont school district administrative regulation could improve compliance with this tax.[7] For property owners who lease their home or space in their home, the regulation states, "Renters/lessees must provide, at the time of enrollment, a copy of the property owner's rental license from the city, in order to be considered a bona fide residence." A student cannot be enrolled if this requirement has not been met.

Business taxes provide the City with a source of revenue that is not property-based. This helps to diversity the city's revenue base and has acted as an important cushion in times of weak property markets. Table 10 shows the percentage change in business tax revenues compared with property taxes and transfer taxes. These are not taxes that fluctuate in tandem over time. In fact, in many years, business taxes move in the opposite direction of the volatile transfer tax.

Piedmont is not unusual in levying business taxes. About 90% of California cities levy some such taxes, which vary considerably across jurisdictions. These taxes are either a flat amount or are levied on gross receipts (like Piedmont) or on the number of employees. Information on these taxes by business type and by jurisdiction can be obtained at: http://www.calgold.ca.gov/

Recommendation #1:

The Committee recommends adding a small business rate to the tax structure for home-based businesses. Currently, the minimum tax is $100, but some residents with specific occupations are charged only $50 for low levels of gross receipts. The Committee recommends that all residents with home-based businesses and gross receipts less than $2,500 be exempt from the business tax. The City would need to verify the level of gross receipts from any resident applying for the exemption.

Because of the restrictions placed on cities by Proposition 218, the Committee would like to emphasize that if the recommendation is implemented by the Council and tax rates are lowered for residents with gross receipts below $2,500, it would take a two-thirds majority vote of the electorate to raise these taxes again at any time in the future. The asymmetric requirements cities are subject to concerning decreasing and increasing taxes are described in Appendix A.

REVENUE SHARES AND TRENDS

Piedmont's General Fund is heavily dependent on the real estate market: in FY 05/06 and FY 06/07, about 60% of Piedmont's General Fund was property-based revenue: *ad valorem* property taxes, transfer taxes and the parcel tax. If charges for current services were calculated net of recreation fees and sewer transfers, this percentage would be even higher. In FY 05/06 transfer tax revenues jumped to over $3.3 million, climbing to 17% of revenues, an all-time high.

Chart 9

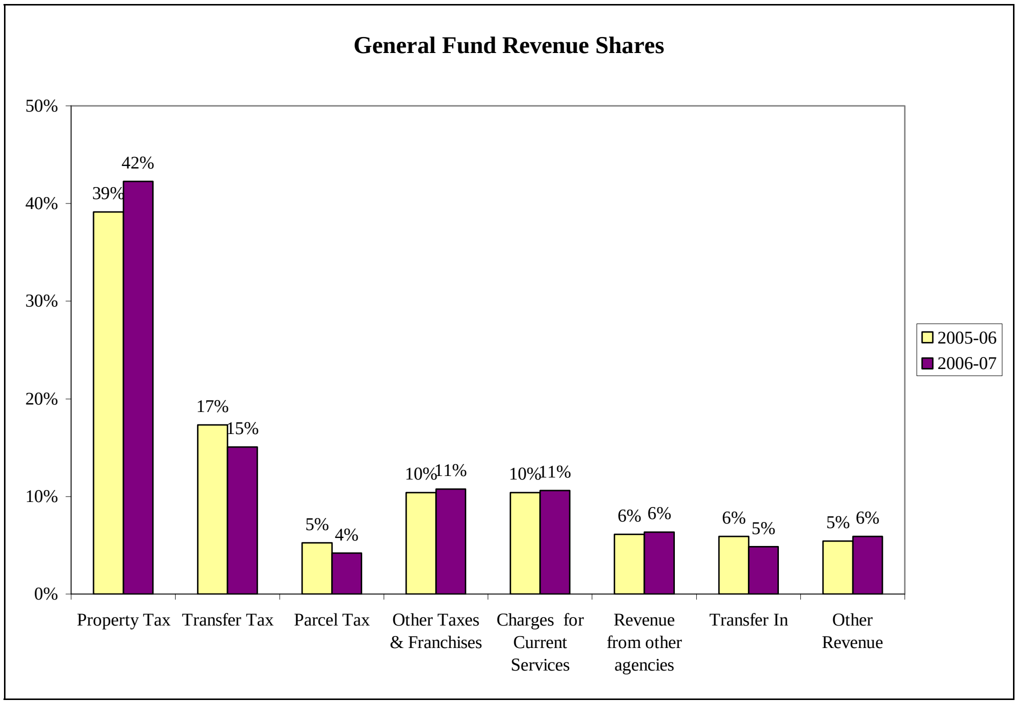


Table 10 gives historical data for property, transfer and business tax revenues back to the early 1990s. The trends in property and transfer taxes are illustrated in Charts 10 and 11. For property tax revenues, growth has been positive since FY 94/95, the end of the sharp downturn in the real estate market in the early 1990s. From FY 91/92 through 97/98, revenues were flat at slightly less than $4 million. In the four years from FY 98/99 through FY 01/02, revenues rose steadily to $6 million. They stayed at $6 million for one year, and then increased by another $2 million in the subsequent four years through FY 06/07. As reported in the FY 07/08 City Budget, property tax revenues are forecasted to increase to $8.7 million in the current fiscal year.

Growth in transfer tax revenue is all over the map, jumping up and down annually. Revenues were about $1 million in the early 1990s. They then increased to over $2 million, and stayed fairly flat for a few years. After decreasing in FY 00/01 to $1.9 million, Piedmont enjoyed an increase to $3.3 million by FY 05/06, with only one dip along the way. Transfer tax revenues declined to $2.9 million in FY 07/08 and are projected to decline further in FY 07/08.

Table 10

Property, Transfer and Business Tax Revenues

Fiscal Year	Property Tax Revenues	%	Transfer Tax Revenues*	%	Business Tax Revenues	
90/91	$3,362,583		$384,494	-9%		
91/92	$3,519,680	5%	$742,598	93%	$156,815	
92/93	$3,402,785	-3%	$730,545	-2%	$204,217	30%
93/94*	$3,802,361	11%	$1,057,885*	45%*	$199,968	-2%
94/95	$3,549,379	-6%	$1,117,941	6%	$201,456	1%
95/96	$3,667,761	3%	$1,127,769	1%	$217,350	8%
96/97	$3,776,332	3%	$1,691,749	50%	$211,716	-3%
97/98	$4,085,609	8%	$2,155,554	27%	$246,540	16%
98/99	$4,388,266	7%	$2,217,684	3%	$239,351	-3%
99/00	$4,734,158	6%	$2,205,378	-1%	$256,084	7%
00/01	$5,325,208	8%	$1,888,647	-14%	$250,768	-2%
01/02	$5,688,020	16%	$2,287,982	21%	$307,527	23%
02/03	$6,022,274	2%	$2,493,805	9%	$334,114	9%
03/04	$6,525,746	8%	$2,953,530	18%	$353,437	6%
04/05	$6,653,923	2%	$2,468,321	-16%	$336,261	-5%
05/06	$7,559,803	14%	$3,349,732	36%	$370,854	10%
06/07	$8,218,211	9%	$2,930,088	-13%	$354,567	-4%
07/08f	$8,715,000	6%	$2,600,000	-11%	$385,000	9%

Source: City of Piedmont *Note: Piedmont's transfer tax rate was doubled in October 1993.
f=forecast, taken from the City Budget FY 07/08.

Chart 10

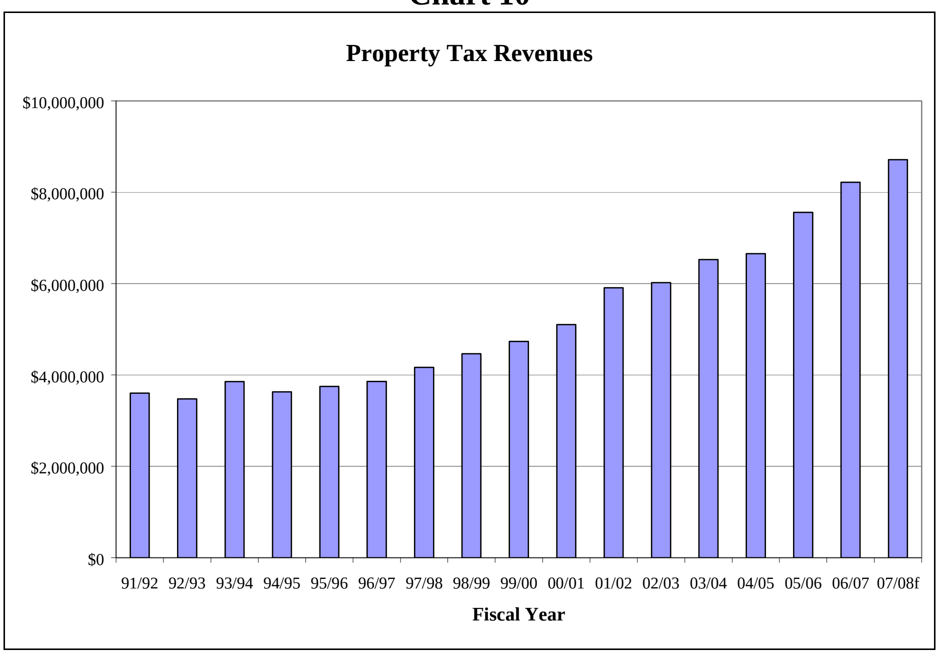


Chart 11

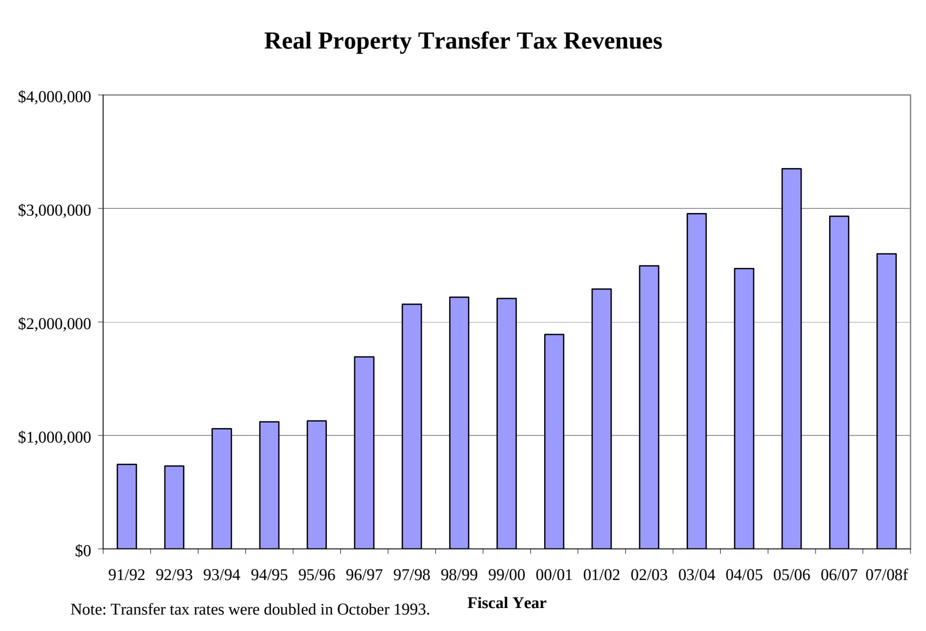


Table 11 shows GF revenues and "transfers in" since FY 99/00. Whether or not transfers are considered, annual revenue growth has been between 2% and 8% in all years except the boom years of FY 01/02 and FY 05/06, when revenues grew between 11% and 16%. Due to an assumed weakness in the property market, projections for FY 07/08 show a decline in GF revenue of 5% to 7%.

Table 11

Total General Fund (GF) Revenues, including Transfers In						
	Total: GF Revenues + Transfers In	% growth	Subtotal: GF Revenues	% growth	GF Transfers In*	% growth
FY 99/00	$12,936,300		$11,732,253		$1,204,047	
FY 00/01	$13,183,276	2%	$12,031,758	3%	$1,151,518	-4%
FY 01/02	$15,173,518	15%	$13,932,672	16%	$1,240,846	8%
FY 02/03	$15,569,397	3%	$14,428,407	4%	$1,140,990	-8%
FY 03/04	$16,484,647	6%	$15,589,897	8%	$894,750	-22%
FY 04/05	$17,377,708	5%	$16,046,932	3%	$1,330,776	49%
FY 05/06	$19,317,763	11%	$18,173,483	13%	$1,144,280	-14%
FY 06/07	$19,449,538	1%	$18,508,789	2%	$940,749	-18%
FY 07/08f	$19,211,176	-1%	$17,851,822	-4%	$1,359,354	44%

Source: City of Piedmont; f=forecast, taken from the City Budget, FY 07/08.
* Examples of revenues included in "Transfers In" from other funds include private contributions, the state gas tax, sewer fund, and the School Mates program.

COMPENSATING FOR STATE TAKE-AWAYS (ERAF) FROM THE CITY

Proposition 13 gave the Legislature the power to reallocate property taxes among local governments and school districts. The most significant use of this authority has been to allocate city, county and special district shares of the property tax to schools through three major property tax shifts and reduce state General Fund support for schools. These property tax shifts, which began in 1992, are referred to as ERAF: the Educational Revenue Augmentation Fund. The ERAF shifts hit cities that are highly dependent on property-based revenues, like Piedmont, hard. Since the ERAF shifts began, the City has received slightly less than a third of Piedmont's total property tax collections. The following table shows the magnitude of the ERAF shifts, the municipal parcel tax, and the amount of property tax received by the City over the past 15 years.

Table 12

ERAF Shifts I, II and III, Municipal Services Tax and Property Taxes

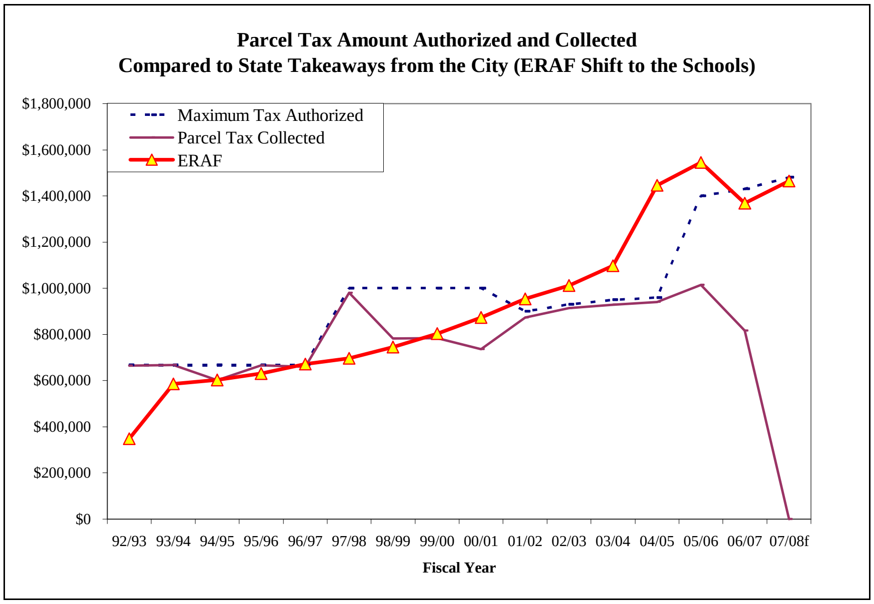
Fiscal Year	ERAF I and II Shift from the City of Piedmont	ERAF III Shift from the City of Piedmont	Piedmont's Municipal Services Tax (parcel tax collected)	Property Taxes Received by the City of Piedmont
92/93	$348,370		$664,882	$3,402,785
93/94	$586,576		$667,812	$3,802,361
94/95	$602,802		$602,162	$3,549,379
95/96	$630,712		$666,719	$3,667,761
96/97	$671,791		$660,380	$3,776,332
97/98	$697,196		$980,873	$4,085,609
98/99	$745,720		$782,902	$4,388,266
99/00	$803,737		$784,294	$4,734,158
00/01	$873,099		$735,823	$5,325,208
01/02	$954,646		$873,934	$5,688,020
02/03	$1,012,211		$915,126	$6,022,274
03/04	$1,098,047		$929,361	$6,525,746
04/05	$1,172,715	$273,220	$940,501	$6,653,923
05/06	$1,272,161	$273,220	$1,014,547	$7,559,803
06/07	$1,368,590	$0	$816,594	$8,218,211
07/08f	$1,464,400	$0	$0	$8,715,000
Total	$14,302,773	$546,440		

Data Sources: City of Piedmont and the County of Alameda. f=forecast

One way to think about why Piedmont has needed a parcel tax in the last 15 years is to link it with ERAF. Since 1992, the municipal parcel tax has essentially been making up for the ERAF shift of property tax funds away from the City to Sacramento for funding public education. Chart 12 shows that the authorized amount of Piedmont's parcel tax closely tracks ERAF shifts.

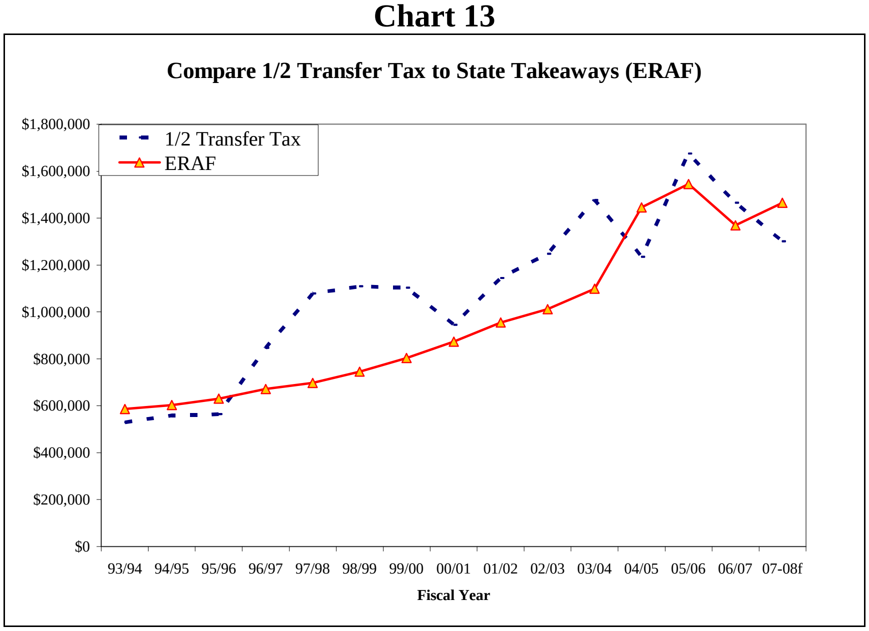
In 2005, then-Councilmember Jeff Wieler proposed that the City adopt a formula for a permanent parcel tax that would tie it to the amount of state takeaways. He suggested that the parcel tax have a maximum limit that is $350,000 less than ERAF I and II takeaways. For FY 07/08, the formula would amount to a parcel tax of about $1.1 million.[8]

Chart 12



An alternative way to think about how the City has compensated for state takeaways (ERAF) is to look at real property transfer tax revenues. In October 1993, Piedmont doubled its transfer tax rates from 0.65% of the sale price to 1.3%. As Chart 13 shows, half of transfer tax revenues are roughly comparable to ERAF. In other words, thought about this way, movers into, within and out of Piedmont have been paying for the ERAF shifts.

Chart 13

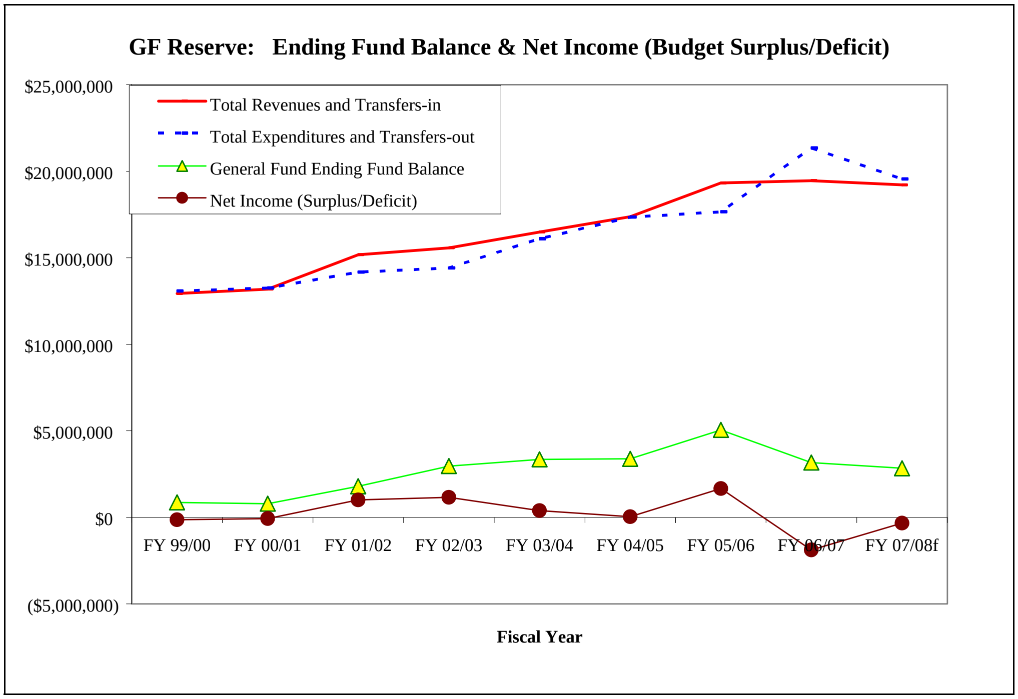


THE GENERAL FUND RESERVE

TRENDS IN GF BALANCE AND RESERVE

Piedmont's ending fund balance, which is the amount of funds remaining in the General Fund at the end of each fiscal year, grew steadily from less than $1 million in FY 99/00 to $5 million FY 05/06. The primary reason for this increase was the strong real estate market, an unanticipated jump in revenues collected from the transfer tax, and the fact that the City Council did not spend these extra revenues. Starting in FY 06/07, the ending fund balance started to come down, primarily due to a large transfer out of the General Fund to the Capital Improvement Project Fund. In FY 07/08, the ending fund balance will drop even further because the parcel tax was not levied.

Chart 14



In addition to the ending fund balance, Chart 14 and Table 13 show GF net income (surplus or deficit) for each year. What is the relationship between these two concepts? The GF surplus or deficit is the difference between flows of expenditures and revenues in a fiscal year. If expenditures are greater than revenues, the GF has a deficit. The fund balance is a stock concept and takes into account the amount of funds available at the beginning of the year, adjusted by the deficit or surplus during the year, and the funds available at the end of the year. The ending fund balance for one fiscal year is equal to the beginning fund balance for the next fiscal year. ***A deficit during the fiscal year means that the ending fund balance will decrease compared with the previous year. A surplus means the ending fund balance will increase.*** In other words, in FY 06/07 and FY 07/08 the GF ending balance declines because the City incurred GF deficits.

These deficits were due to increased spending on capital improvements and tax relief (zero parcel tax levied).

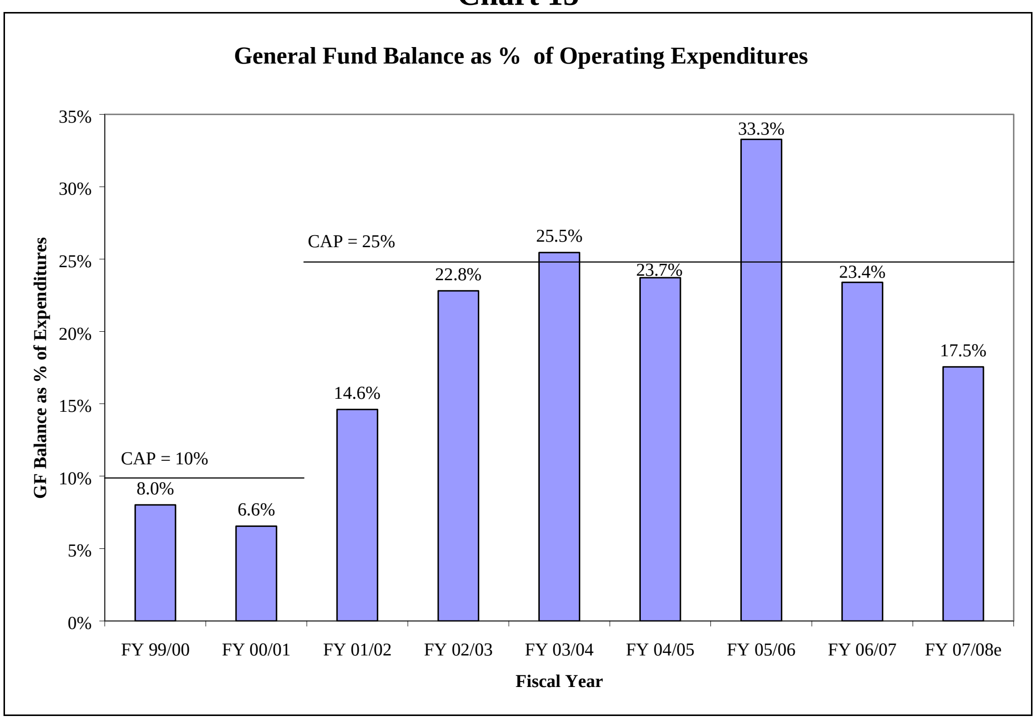
Table 13

General Fund Income Flows (Deficit/Surplus) and Stocks (Fund Balance)

	Measure A		Measure G	
Millions of dollars	FY 99/00	FY 00/01	FY 01/02	FY 02/03
GF Beginning Fund Balance ($m)	$1.0	$0.9	$0.8	$1.8
GF Revenues and Transfers-in ($ m)	$12.9	$13.2	$15.2	$15.6
GF Operating Expenditures and Transfers-out ($m)	$13.1	$13.3	$14.2	$14.4
GF Net Income (GF Surplus/Deficit) ($m)	-$0.1	-$0.1	$1.0	$1.2
GF Ending Fund Balance ($m)	$0.9	$0.8	$1.8	$3.0
	Measure G		Measure W	
	FY 03/04	FY 04/05	FY 05/06	FY 06/07
GF Beginning Fund Balance ($m)	$3.0	$3.4	$3.4	$5.1
GF Revenues and Transfers-in ($ m)	$16.5	$17.4	$19.3	$19.5
GF Operating Expenditures and Transfers-out ($m)	$16.1	$17.3	$17.7	$21.3
GF Net Income (GF Surplus/Deficit) ($m)	$0.4	$0.0	$1.7	-$1.9
GF Ending Fund Balance ($m)	$3.4	$3.4	$5.1	$3.2

Piedmont's General Fund reserve is limited to 25%. This cap was increased from 10% to 25% in 2000 by popular vote. Chart 15 shows the trend in GF reserve percentages since FY 99/00.

Chart 15



In good financial times, accumulating a reserve is a good idea so that the City will have a financial cushion. The General Fund reserve can be viewed as an insurance policy against future revenue shortfalls and the resulting cuts in city services. Accumulating a healthy ending fund balance also gives the City the opportunity to save for larger, long-term projects and plan ahead for known cost increases if necessary. On the other hand, residents do not want the cushion to be "too high" so that the City is sitting on large reserves unnecessarily and over-taxing residents.

In considering the implications of the trends in Charts 14 and 15, the Committee grappled with several major questions, including: How high should Piedmont's GF reserve limit be? Why doesn't Piedmont have a reserve minimum or a desired target? What are reserve policies in other cities? How are reserve policies calculated? Is it common practice to have reserve minimum, a desired target, and/or a maximum limit? If a city does have a reserve limit, is it binding? In other words, are there consequences if the limit is exceeded or is it simply a guideline?

Another general issue discussed concerns whether a city's reserve policy is formulated by ordinance or resolution at budget time, placed in the City Charter or adopted as an informal guideline.

Piedmont has a reserve limit specified in the City Charter. To change a reserve limit placed in a charter, an election and a simple majority vote of the people is necessary. This is cumbersome and to some degree, takes away a policy tool from the City Council. On the other hand, changing a reserve limit promulgated by Council resolution during the budget process, for example, requires a majority vote of the City Council.

The language in the Charter follows:

> The Council shall establish a fund known as the "General Fund Reserve" in an amount not to exceed twenty-five (25%) of the budget for the purpose of maintaining municipal services during periods of reduced revenues to the City, as well as meeting unforeseen contingencies and emergencies of the City.

One interesting thing is that the Charter uses one definition of the cap (25% of the budget) but Piedmont's current parcel tax, Measure W, specifies another calculation: The ending fund balance as a percentage (25%) of operating expenditures. These definitions are not the same. Operating expenditures do not include transfers out, but "the budget" does include transfers. Interestingly, it is the language specified in the parcel tax that is actually used...not the language specified in the Charter.

Piedmont's current parcel tax also includes a trigger mechanism to decrease the parcel tax if the reserve limit of 25% is exceeded. This trigger was activated, for example, when the reserve percentage climbed to 33% in FY 05/06. This trigger mechanism does not reside in the Charter.

GENERAL FUND RESERVE POLICIES IN OTHER CITIES

Best Practices: Government Finance Officers' Association (GFOA)

How large is the average General Fund reserve in other cities? Several previous Piedmont tax committee reports have cited an article from the Government Finance Review (1994) called "GFOA's Financial Indicators Database: Benchmarking and Other Uses." This article looked at 209 U.S. cities with population ranging between 10,000 and 25,000 persons and found that the median GF reserve was approximately 15% of expenditures.

The GFOA has not updated its 1994 study, but it did issue a policy recommendation on GF reserves in 2002. The GFOA policy recommends a minimum GF reserve of 5% to 15% of operating revenues or one to two months of operating expenditures (one to two months translates into about 8% to 17% of operating expenditures).[9] According to the GFOA,

> The adequacy of unreserved fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, *at a minimum*, that general-purpose governments, regardless of size, maintain unreserved fund balance in their general fund of no less than five to 15 percent of regular general fund operating revenues, or of no less than one to two months of regular general fund operating expenditures. The choice of revenues or expenditures as a basis for comparison may be dictated by what is more predictable in a government's particular circumstances. In either case, unusual items that would distort trends (e.g. one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unreserved fund balance to either revenues or expenditures, that decision should be followed consistently from period to period. In practice, levels of fund balance (expressed as a percentage of revenues/expenditures or as a multiple of monthly expenditures) are less for larger governments than for smaller governments because of the magnitude of the amounts involved and because the diversification of their revenues and expenditures often results in lower degrees of volatility.

Smaller cities with a less diversified tax base, such as Piedmont, are advised to hold reserve percentages at the higher end of the suggested range, in other words, 15%.

General Fund Reserve Comparison with Other Cities

Committee members asked Piedmont Finance Director Mark Bichsel to survey surrounding cities to give us an idea of how large other cities' reserves are. Table 14 compares Piedmont's reserve in FY 05/06 to other cities. The data suggest that cities hold a reserve in the range of -4% to 116% with Piedmont, at 33%, landing somewhere in the lower middle range.

Table 14

General Fund Balance Analysis, FY 05/06, Fiscal Year Ending June 30, 2006				
	Operating Expenditures	Year End Fund Balance	Unreserved Fund Balance	Unreserved Fund Balance as % of Operating Exp
Mountain View	$73,052,000	$111,451,000	$84,605,000	116%
Tracy*	$47,600,000		$3,700,000	70%
Pleasant Hill	16,037,277	11,120,439	10,934,837	68%
Brentwood	33,419,442	22,514,337	22,310,261	67%
Foster City	25,645,567	32,424,811	16,185,228	63%
Hillsborough	16,093,968	9,802,887	9,791,991	61%
Emeryville	24,328,485	11,381,358	10,375,140	43%
San Marino	16,217,623	8,052,697	6,898,642	43%
Livermore	71,778,184	34,917,037	25,587,347	36%
Piedmont	**15,182,646**	**5,053,075**	**5,053,075**	**33%**
Benicia	25,750,403	7,976,927	7,736,096	30%
Alameda	67,313,126	24,573,726	17,947,381	27%
Mill Valley	18,100,000	4,880,000	1,682,000	9%
San Rafael	44,974,687	5,697,542	3,362,151	7%
Sausalito	10,679,715	5,357,665	(131,095)	-1%
Corte Madera	13,980,550	(590,073)	(615,552)	-4%
Source: City of Piedmont, July 2007. Phone survey of cities by Mark Bichsel, Finance Director. * City of Tracy: Zane H. Johnston, *Fiscal Issues Related to General Fund Reserves*. March 2007.				

CSMFO Surveys

Several surveys have been conducted in the past two years among members of the California Society of Municipal Finance Officers (CSMFO) concerning General Fund (GF) reserve policies.[10] These surveys are summarized in this section to provide more information on how Piedmont's reserve policy compares with that of other cities.

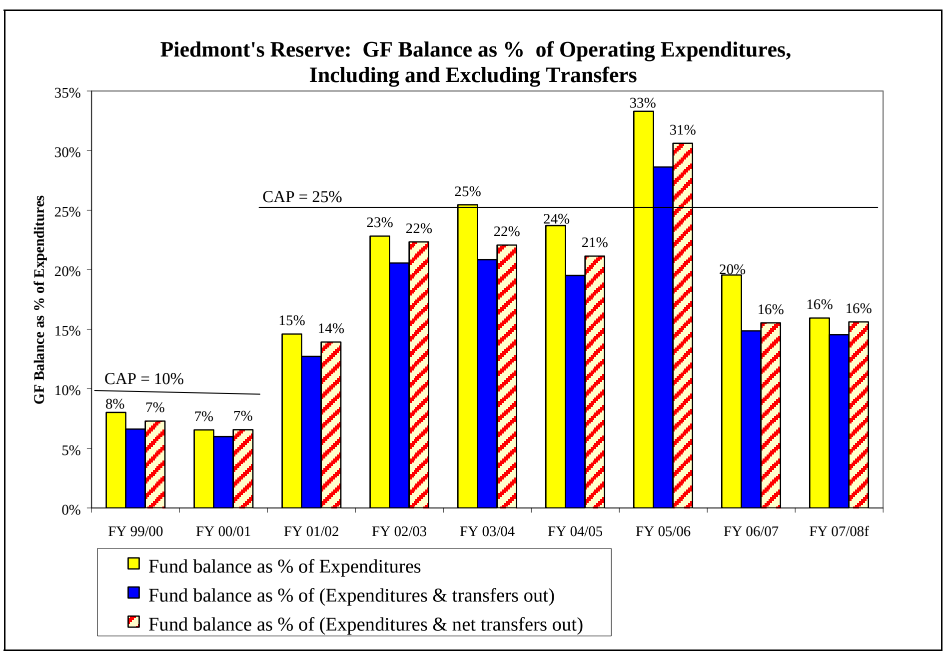
When considering reserve percentages across cities, one immediately notices that GF reserve policies are calculated in a number of ways. Table 15 gives several examples. It is interesting to note that one recommendation of Piedmont's 1995 Municipal Tax Review Committee, which was not implemented, was to include "net transfers out" in the denominator when calculating the reserve percentage. The 1995 report also states that Piedmont (like Hillsborough) needed a higher reserve than elsewhere because of a lack of retail activity.

Table 15

General Fund (GF) Operating and Emergency Reserve Calculation
GF Ending Balance as a percentage of different denominators:
Current appropriations for economic uncertainties
Annual operating budget for economic uncertainties
GF expenditure budget for economic contingency
GF operating budget
GF appropriations
GF operating expenditures
Operating budget, excluding one-time expenditures and internal service fund rates
GF operating expenditures and net transfers
GF expenditures, minus capital purchases
GF operating expenditures, excluding one-time, transfers and capital
GF operating expenditures, net of debt service and capital transfers
GF operating expenditures, excluding transfers out
Projected GF Revenues
GF revenues
Other Ways to Calculate Reserves:
Minimum Flat Amount (for example, $1 million)
Minimum Flat Amount, increased by the CPI each year

For Piedmont, Chart 16 illustrates how including "transfers out" or "net transfers out" in the denominator would affect the reserve percentage. For example, including "net transfers out" results in a decrease of the reserve percentage by a range of 0 percentage point (FY 00/01) to 5 percentage points (FY 06/07).

Chart 16



Survey Results #1:
A July 2007 CSMFO survey of 63 California cities that specifically asked about reserve minimums and maximums (caps) revealed the following:

- 52 cities did not have a reserve cap, but most had minimums or desired targets.
- For the 11 cities with a reserve cap, only one (Glendale) had a limit specified in its city charter. In the other 10 cities, the limit was adopted by resolution of the local governing board, by ordinance, or as an informal policy statement in the annual budget process.
- Reserve minimums, maximums and targets can be calculated in many different ways.
- Most reserve minimums were adopted as a resolution. A few were adopted as an ordinance. Some were informally adopted as part of the cities' financial policies. None were specified in the city charter.
- In some cities, any excess over the reserve cap is automatically transferred to the Capital Projects Fund. In other cities, these caps are simply guidelines and can be exceeded if approved by the Council.[11]
- In nine of the 11 cities with a reserve cap, the maximum percentage was higher than Piedmont's 25%: one city used 27.5%, six used 50%, one used 75% and one had two formulae (35% and 50%).
- The following 11 cities reported having reserve caps (a maximum percentage):

Table 16

Examples of 11 Cities with Reserve Caps

City	**Min**	**Max**	**Reserve calculation: Ending Fund Balance as a % of…**	**Charter? Resolution? Ordinance? Guideline?**
Redwood City		15-20%	Anticipated revenues	Resolution. A target.
Indio		25%	Operating expenditures	Resolution
Morro Bay		27.5%	GF operating budget	Resolution
Glendale	30%	35%	GF appropriation	Resolution
		50%	*Ad valorem* taxes	Charter
Rancho Palos Verdes		50%	GF revenues	Informal city council policy, guideline
Sierra Madre		50%	NA	Ordinance
Emeryville	25%	50%	GF operating revenues	Resolution; revisited at least every 2 years
Mission Viejo		50%	GF Group (GF + 2 asset replacement funds)	Resolution
Suisun City		50%	GF operating expenditure	Finance Policy
Palos Verdes Estates		50%	Total operating budget	City Council policy statement
Stanton		75%	GF revenues	Administrative policy

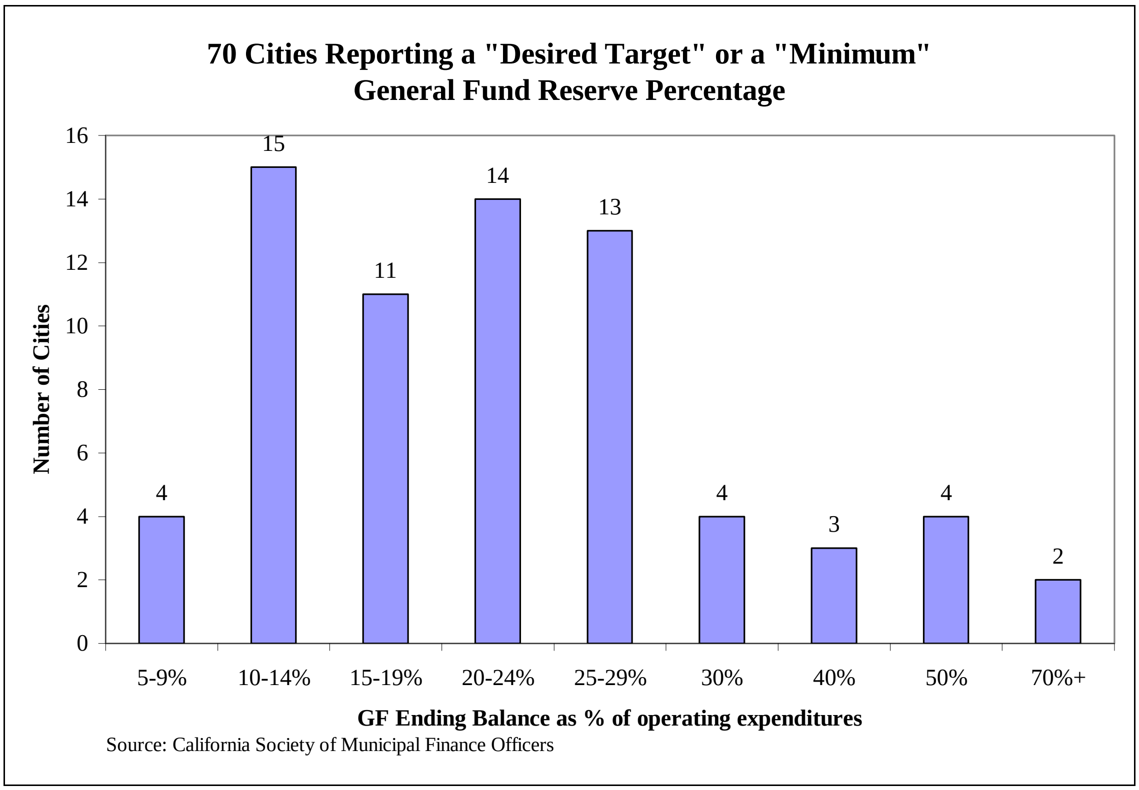
Source: California Society of Municipal Finance Officers, Unpublished Survey, July 2007.

Survey Results #2:

In Fall 2006, several other surveys were conducted by CSMFO concerning reserve policies. These surveys did not specifically ask about reserve caps (because most cities do not have them) but did ask about General Fund reserve policies.

For 70 cities, Chart 17 shows the distribution of cities in the 2007 and 2006 surveys reporting a minimum GF reserve percentage calculated using ending fund balance as a percentage of operating expenditures. Most of these cities had a minimum or target between 10% and 29%.[12]

Chart 17



Finally, it should also be noted that most cities are not charter cities. In FY 03/04, for example, out of the 478 cities in California, only 108 (or 23%) were charter cities. Most charter cities have significantly larger populations than Piedmont does.

The conclusions from this General Fund reserve analysis across cities are:

- Most cities surveyed did not have a reserve cap (maximum reserve percentage). Even fewer had a binding cap (e.g. a requirement to reduce General Fund spending or transfer funds out of the General Fund if the cap were exceeded).
- Piedmont's 25% maximum cap is low relative to most other cities that have a cap. Most cities' caps were about 50%.
- Most cities surveyed did have a minimum reserve percentage and/or a desired target reserve percentage and for many cities, this minimum is in the same range as or higher than Piedmont's maximum of 25%.
- The Government Finance Officers Association recommends a *minimum* reserve percentage of about 15% for a city like Piedmont (with a small population and narrow revenue base). With Piedmont's maximum at 25%, this does not allow the City much flexibility.
- Only about 25% of California cities are charter cities. Among charter cities surveyed, only Glendale had a maximum cap (50% of *ad valorem* taxes) in its charter for its General Fund reserve. Glendale also had additional maximum and minimum reserve percentages decided by resolution of the city council.

If Piedmont's reserve policy were under review on an annual basis, the Council could discuss the level of the cap in the context of budget deliberations. The Council could also implement a reserve minimum, perhaps on the order of 10%. Taking the reserve cap out of the Charter would not prevent the Council from including a reserve percentage as a trigger mechanism for the parcel tax.

Recommendation #2

The Council should review the City's General Fund reserves on an annual basis and establish minimum reserve limits or maximum reserve limits, as necessary, as part of the overall financial planning process, thereby facilitating immediate responses to unfavorable or favorable fiscal trends as they arise. To implement this recommendation, the Council should approve a ballot measure to be voted upon at the next general election to remove the reserve percentage cap from the City Charter. Instead the ballot measure would authorize the Council to establish minimum reserve limits or maximum reserve limits, as necessary, by resolution of the Council or by an ordinance.

FINANCIAL ANALYSIS

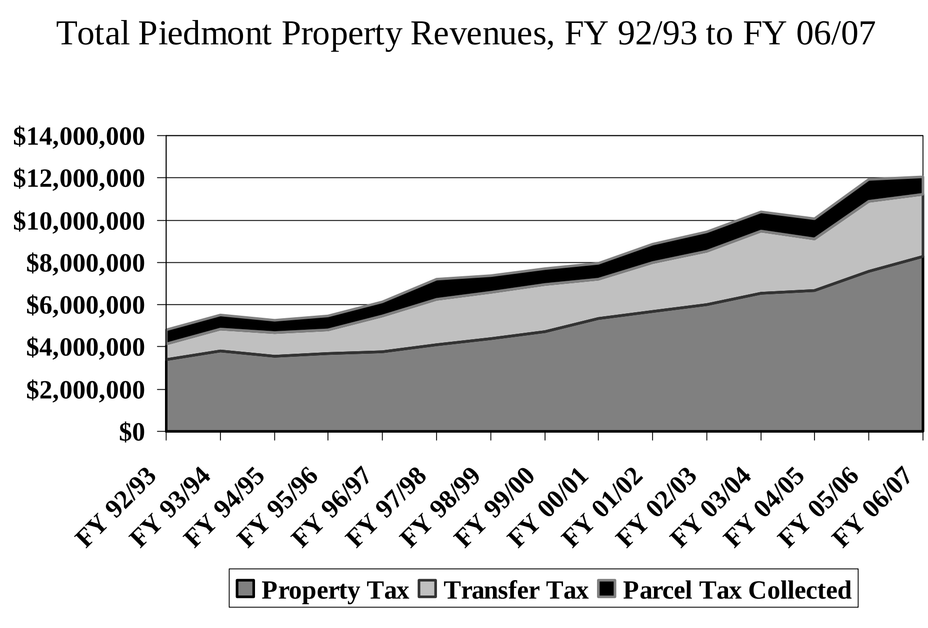
PROPERTY REVENUES

Excluding permit fees, Piedmont has three types of property revenues. These are:

- *property tax*: assessed of property owners annually based on the assessed value of the property.
- *transfer tax*: paid at time of sale, this is currently 1.3% of the sales price of the home.
- *parcel tax*: rate set annually by the City Council, based on an amount authorized every four years by Piedmont voters; assessed by parcel size.

Property-related taxes are Piedmont's largest single source of revenue. Property-related revenues vary annually, although in general they have been rising, as shown in the Chart 18. The rate of change for both property and transfer taxes has been quite volatile, leading to actual decreases in revenues in some years, and strong growth in other years. These trends are discussed in more detail in the report's section on "Revenues."

Chart 18



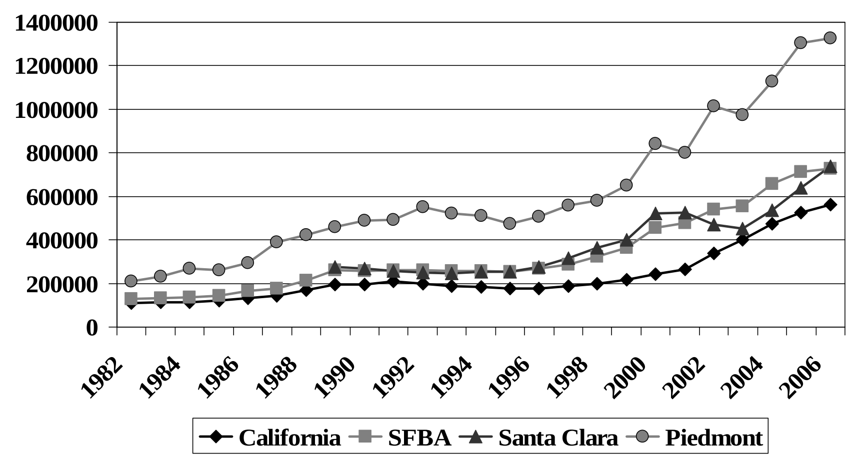
Source: City of Piedmont.

Piedmont's Property Market

Piedmont homes sell at well above the Bay Area average. The median price of a Piedmont home in 2006 was $1,325,000, compared to median prices of $560,500 statewide, $726,000 in the Bay Area as a whole, and $738,000 in Silicon Valley. There is sometimes a perception that Piedmont's unique qualities that lead to this price premium also cushion property values from downturns. In fact, as shown in the following figures, sales prices in Piedmont respond similarly to prices in the San Francisco Bay Area and in the state as a whole.

Chart 19

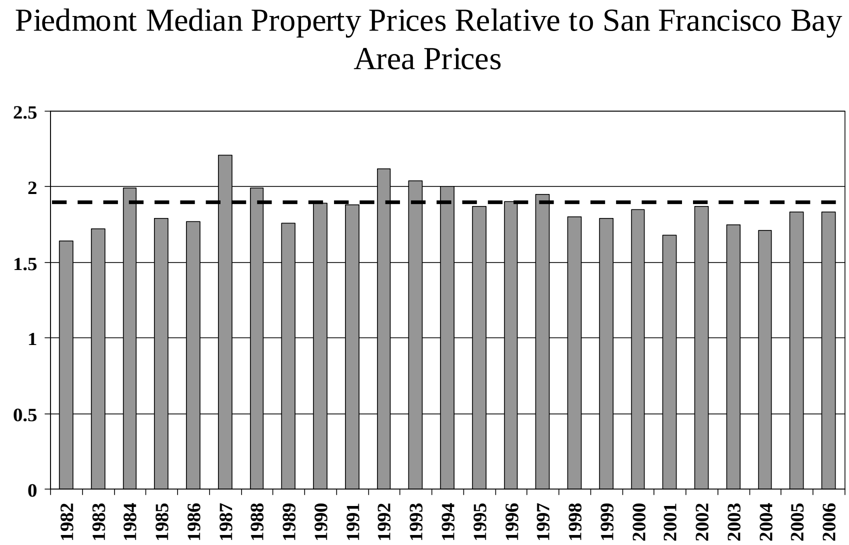
Median Price Trends, Piedmont, San Francisco Bay Area, Santa Clara County, and California



Source: Computed from Alameda County property records and California Association of Realtors data.

The median home price in Piedmont has dipped in several periods. It took five years for the city's home values to recover from the price downturn that began in 1993, at the end of two years of recession in the California economy. While Piedmont homes values in 2006 were well above their level in 2000, in fact median prices dropped sporadically even during this six-year period, and the overall level relative to Bay Area prices is no higher than it has been over the full 25-year period, as shown in Chart 20. The median Piedmont home currently sells for an 83% premium over the median San Francisco Bay Area home.

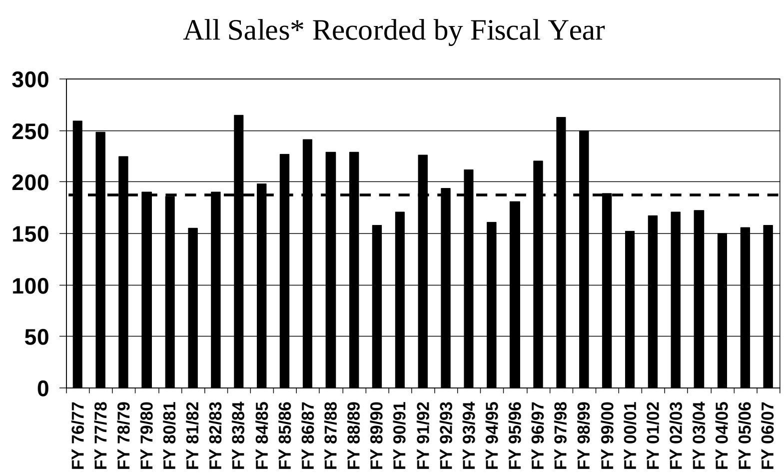
Chart 20



---- Average level 1.87.
Source: Computed from Alameda County property records and California Association of Realtors data.

Property values in Piedmont, then, are not immune from downturns. The number of sales also varies widely by year. Between FY 86/87 and FY 06/07, the number of sales ranged from 150 in FY 04/05 to over 260 in FY 97/98.[13]

Chart 21



Source: Compiled from City of Piedmont property data base, based on Alameda County Assessor data provided through a 3rd party provider.
---- 20 year average, 191 sales (10 year average 182).
* Total of all sales reported in the property data base. Where a property has sold more than 3 times, the earlier sales are excluded from the data base. FY 00/01 and forward are direct reports from Alameda County. Data for FY 93/94 on is from Alameda County.

Our analysis considers how the property market may fare over the next six years and how different real estate market conditions, as measured by sales price and number of sales, could affect the city's property tax and real property transfer tax revenues.

Property Tax Revenues and Assessed Value

Property tax revenues are determined by several factors, including:

- Assessed value of property
- Tax rate set primarily by Proposition 13
- ERAF shifts

Details of Proposition 13 and ERAF shifts (property tax revenues shifted away from the city, to the state) are described in Appendix A. Understanding how revenues may change in the future requires a further look at the assessment process.

Assessed value is shaped by Proposition 13 and by the current real estate market. Until the passage of Proposition 13 in 1978, properties were reassessed on a regular basis based on the change in "fair market value" of the property. Proposition 13 changed this process, requiring that properties be reassessed to fair market value only upon sale, and limiting the rate at which property could be taxed to 1% of assessed value. A city's ability to raise the tax rate based on property value is highly restricted, but taxes based on other factors (such as parcel size) may be passed by a two-thirds supermajority of the voters.[14]

This framework does not leave property assessments static. In the years following a sale, assessments can be raised by no more than 2% annually (based on the overall CPI; assessments can be augmented additionally based on value increases due to remodeling). Piedmont's total assessed value in FY 06/07 was approximately $2.6 billion, or an average of close to $650,000 per property. On a square-footage basis, Piedmont properties average assessed value was $261/square foot, compared to a peak sale price in FY05/06 of $650/square foot.

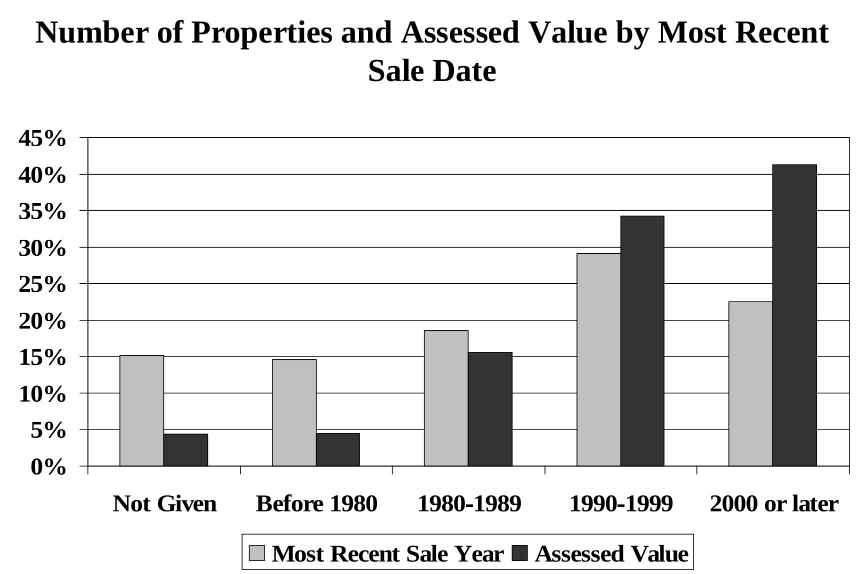
To summarize, then, a property's assessed value is determined by:

- Sales price at time of most recent sale, or assessed value in 1975, whichever is more recent
- Inflation adjustment of up to 2% per year since most recent sale
- Value of property remodels to the extent that they are improvements, rather than repairs. (We did not attempt to estimate this in our model.)
- The assessment can be adjusted downward if prices have dropped within the market to a level lower than the property's assessed value.

This process, while leading to a host of complications in fiscal planning over the past 30 years, has lent some stability to the growth of property valuation. Because only a small proportion of properties turn over in any one year, overall assessed value goes up much more slowly than sales prices in periods of housing price appreciation, but are also much less likely to drop in periods of declining home prices. [15]

As shown in the Chart 22, about three fourths of the assessed value of Piedmont properties is in parcels that sold as recently as 1990, but these parcels include just over half of all parcels in Piedmont. Over one-third of properties have not changed ownership since 1990, and now account for about 20% of assessed value. (Sale year is not available for the remaining 15% of properties, but their low share of assessed value suggests that these properties also have not turned over in at least 20 years). Exhibit D.1 in Appendix D shows how the distribution of assessed values in Piedmont has changed over the past eight years.

Chart 22



Source: Compiled from City of Piedmont property data base, based on Alameda County Assessor data provided through a 3rd party provider.

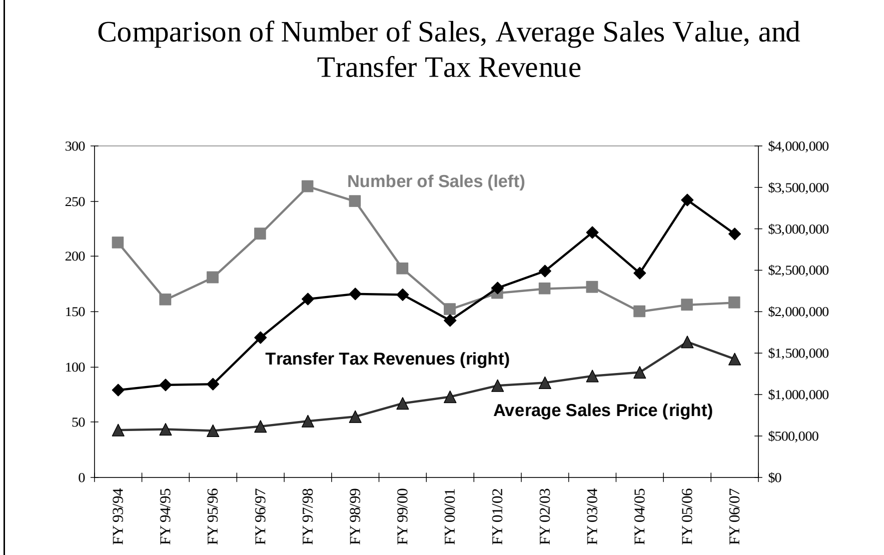
Sales Activity and the Real Property Transfer Tax

Real property transfer tax revenues are based on two factors:

- The number of sales
- The sales prices of properties sold

Both of these factors can vary widely from year to year. As a result, real property transfer tax revenues have risen by as much as 50% in a single year (FY 96/97) or dropped by as much as 16% (FY 04/05) from the previous year. Piedmont's transfer tax revenue has been greater than $2 million since FY 97/98, with the exception of FY 00/01.

Chart 23



Source: City of Piedmont and computed from property data base.

How Will the Current Housing Market Translate into Future Property Revenues?

We used a data base of Piedmont's properties to construct a simulation model based on a set of spreadsheets that allows us to examine how different sales levels and rates of appreciation or depreciation would affect the overall property tax base and transfer tax revenues. The basic structure of the model is described in Appendix C. This should be seen as an informational exercise rather than a set of projections. The purpose of the exercise is to understand the direction property-related revenues may take in the next few years.

The estimates require assumptions regarding the strength of the economy and in particular the housing market. The direction of the housing market in the US, California, and thus Piedmont is extremely uncertain right now. For several years, a number of factors drove up home sales and prices:

- Federal Reserve interest rate policy kept interest rates low.
- Investors seeking high yields became increasingly willing to accept higher credit risk.
- Liberalized credit policies made mortgages available for the first time to individuals with weak credit histories, adding to demand for home ownership.
- Homebuyers became increasingly willing to take on risky adjustable-rate and interest-only mortgages based on the expectation that increasing home prices would bail them out if they got in trouble.
- This growing demand led to continued house price increases, creating momentum and encouraging speculation.

For a time, these factors were mutually reinforcing, but all booms end, and these factors may also work in reverse to reduce the number of sales and lower prices. As some borrowers began to falter, rising delinquencies and defaults scared lenders and investors, leading to tighter credit standards and higher interest rates, and reducing the pool of potential homebuyers. This in turn can affect home prices. Existing home sales in California are down 27.8% from a year ago, according to the California Association of Realtors. The median home price is up 2%, but this may say more about the change in mix of sales than changes to the value of a particular home. According to the 2nd Quarter 2007 OFHEO index, based on repeat sales, home values have dropped by 1.4% in California and by 3.3% in the East Bay over the past year.

While some real estate professionals are optimistic and suggest this will lead to a short hiatus, especially in high end housing markets such as Piedmont, some economic analysts are predicting a longer slowdown and more severe drop in home prices--perhaps as much as 25% (for the entire US, all home levels). As a desirable city, Piedmont may be less vulnerable than less desirable places. However, as it becomes difficult to get credit, and credit becomes more expensive for "jumbo" mortgages, high end markets such as Piedmont will not be immune to what is happening in the mortgage market.

Given these uncertainties, we consider a range of possible home sales experiences in Piedmont over the next several years. The most optimistic scenario has a brief slowdown in sales, but prices continue rising, much as they have in strong expansion periods. The pessimistic scenario has price declines and lower sales, with recovery occurring only several years out, an experience similar to the slowdown that occurred in the early 1990s. The total price decline is close to 20% over a three-year period, including the drop that already occurred in FY 06/07. The middle scenario has no further price declines, but slower price appreciation and a slower rate of sales than the optimistic scenario. These three scenarios are summarized in table below.

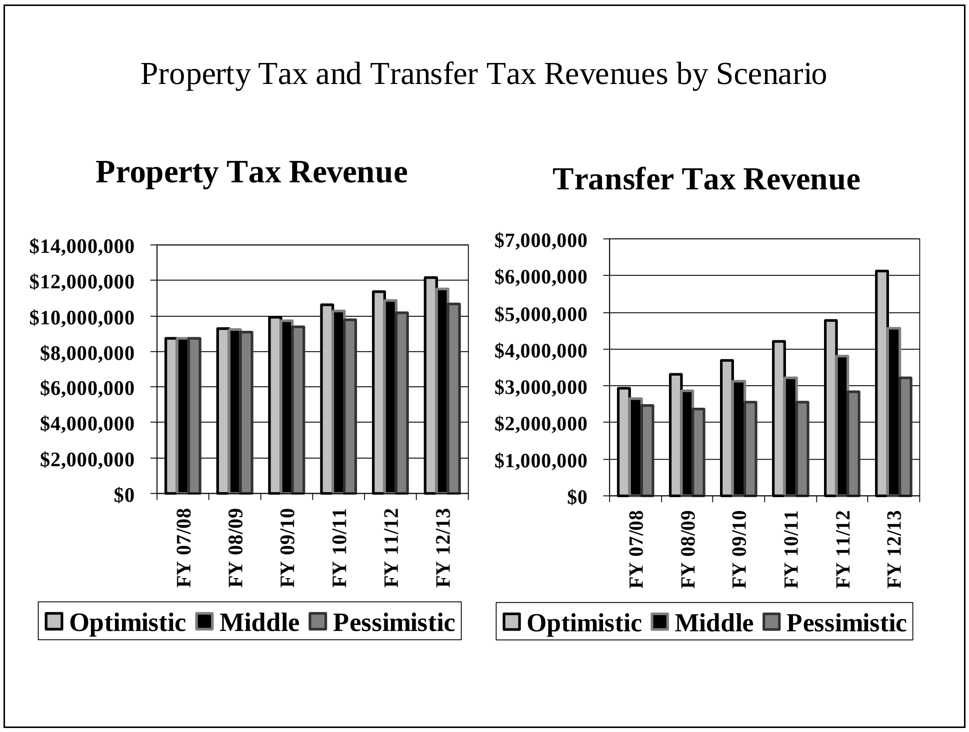
Table 17

Three Scenarios for Piedmont's Property Market
Number of Sales and Price Change

	07/08	08/09	09/10	10/11	11/12	12/13
Scenario I: Optimistic—Sales and prices recover this year						
I: # Sales	140	150	160	170	180	210
I: Price Change	5%	5%	5%	7%	10%	10%
Scenario II: Middle Range—Prices flat until FY 09/10; Sales rise slowly						
II: # Sales	130	140	150	150	170	190
II: Price Change	0%	0%	2%	3%	5%	7%
Scenario III: Pessimistic—Prices drop further, Sales recover slowly						
III: # Sales	130	130	140	140	150	160
III: Price Change	-7%	-4%	0%	0%	4%	6%

These three scenarios lead to differences in property tax and transfer tax revenues. Property tax revenues will grow 47%, not adjusting for inflation, under the optimistic scenario, between FY 06/07 and FY 12/13, but only 29% in the pessimistic scenario. For the same time period, transfer tax revenues could increase 109% under the optimistic scenario, but only 10% under the pessimistic scenario. For Piedmont, in FY 12/13, this would imply property-related revenues (excluding parcel tax revenues) could range from a low of $13.9 million to a high of $18.3 million, compared to a FY 06/07 level of $11.2 million. In percentage terms, this is a range of revenue growth from 3.6% annually in the pessimistic case, to 8.5% annually in the optimistic case.

Chart 24



All of these scenarios are realistic. In the case of the strongest housing market, Piedmont would continue to have a stable fiscal base with no parcel tax. In the case of the weakest housing market, even though revenues grow above the rate of inflation, costs are expected to grow more quickly, because of salary-related commitments (pensions, health care, and competition for safety workers). The City would need a parcel tax as large as the current authorized level to avoid a mushrooming deficit. These implications are discussed in the **Parcel Tax Scenarios** section.

PARCEL TAX SCENARIOS

These scenarios build off the property revenue scenarios of the **Property Revenues** section. The base scenarios all build on the median expected level of expenses provided by Mark Bichsel, Piedmont's Finance Director. In particular, the assumptions embedded in the forecasts include:

- Capital outlays grow at 3% per year
- Maintenance and operations costs grow at 2% per year (library costs remain unchanged and the city does not take over the swimming pool)
- Administrative salary costs grow at 4% per year
- Police and Fire salary costs grow at 5% per year
- Pension costs grow at the same rate as salaries
- Health care costs grow at 10% per year
- The state does not declare an emergency that would require another emergency ERAF takeaway.
- Revenues, apart from property-related revenues, grow at 2.5% annually.

Total expenditures over this period, before transfers out, grow from $16.1 million in FY 06/07 to $21.8 million in FY 12/13 (an annual growth rate of 5.3%). Including transfers out, expenditures grow from $21.3 million to $24.8 million.

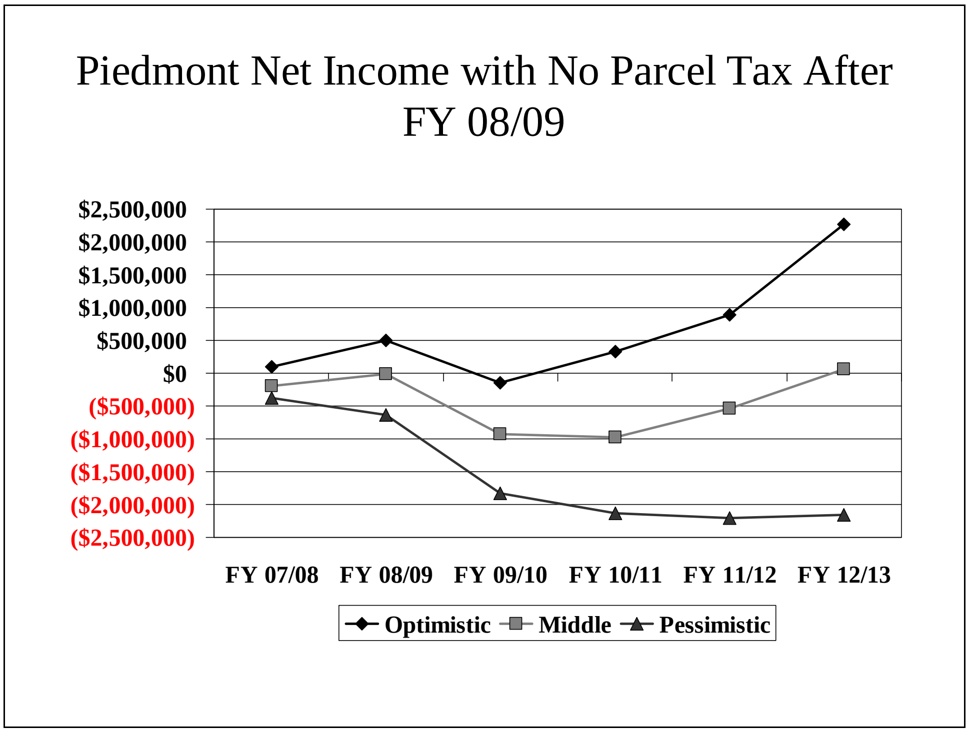
Using the property revenue scenarios described earlier, we examine what happens to Piedmont's general fund ending balance annually during the parcel tax period with strong, weak and intermediate property markets. We consider three different parcel tax alternatives:

- No parcel tax beginning in FY 09/10
- A $1.5 Million/$1 Million/$0 alternative in which the authorized tax is:
  - $1.5 million (inflated by the CPI annually—assumed to be 2.5% in this analysis) when transfer tax revenues are below $3.5 million,
  - $1 million (inflated as above) when transfer tax revenues are at $3.5 million or above, but below $4 million, and
  - $0 when transfer tax revenues are at $4 million or above.
  - Note that in crafting this tiered tax, it would be prudent to restore the full authorized level to the extent that additional revenue is siphoned off by an emergency state ERAF.
- A $1 million parcel tax (inflated as above) when transfer tax revenues are below $3.5 million. At levels above $3.5 million, the parcel tax is reduced by twice the difference between transfer tax revenues and $3.5 million. [ERAF caveats would be prudent for this tax as well.]
- For all examples, we assume the city assesses a $1 million parcel tax in FY 08/09 under the current parcel tax authorization.

No Parcel Tax

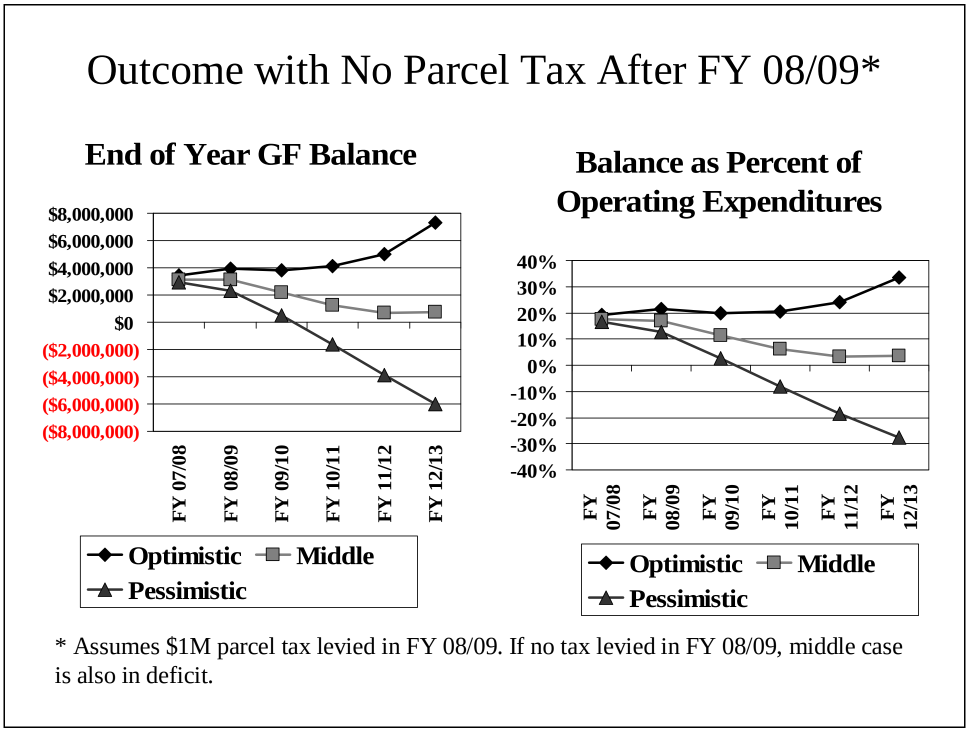
Chart 25 shows the consequences of the choice not to renew the parcel tax. In terms of the balance between revenues and expenditures, even in the most optimistic scenario Piedmont would spend more than it takes in during FY 09/10. This is manageable for a single year, and revenues exceed expenditures at a growing rate in later years. In the moderate case, Piedmont would face three years of deficit spending, while in the pessimistic case, the City would need to spend on the order of $2,000,000 more than it was taking in for each of the four years of the parcel tax period.

Chart 25



Partly because there would be reserves from previous years, Piedmont's General Fund would stay in the black with an adequate and growing surplus if property markets are strong. In a medium property market, the City would stay in the black despite three years of deficit spending, but the reserve becomes below a prudent level in all years, and is below 4% in FY 10/11 and FY 11/12. Piedmont has a growing general fund deficit with a weak property market. If sales remain slow, the deficit becomes cumulative over time, and the expected levels of spending would be unsustainable.

Chart 26



$1.5 Million/$1 Million/$0 Parcel Tax

A $1.5 million parcel tax would be a continuation of the current level of authorization. The method we propose, which drops back to $1 million as transfer tax revenues rise and to $0 on reaching transfer tax levels of $4 million or more, gives Piedmont taxpayers additional assurance that the tax will not become a means of increasing spending without voter oversight. The Council of course would have the option of assessing a lower tax were they to determine that the fully authorized amount was not needed. Piedmont city councils in the past have been prudent in considering when and at what level they assess parcel tax monies.

A $1.5 Million/$1 Million/$0 parcel tax would provide much more flexibility for different market conditions. In the optimistic scenario, were the parcel tax assessed at its full allowable level every year after transfer tax-related constraints were applied, by FY 12/13, the General Fund end-of-year balance would be 47% of operating expenditures (not including transfers out). In the medium scenario, the fund balance gradually rises to 32% of operating expenditures by FY 12/13. With the weaker (pessimistic) housing market, the general fund end-of-year balance would drop steadily, but would remain positive throughout the parcel tax period. In the last two or three years, the city might be faced with some capital expenditure postponements to keep a prudent reserve, but would be able to maintain other operating expenses.

In the optimistic scenario, the parcel tax could be assessed at the full $1.5 million only in the first year. By the second year the authorized level would drop to $1 million, and by the third and fourth years, the authorized level would be $0. In the middle scenario, the authorized level would drop to $1 million (plus CPI adjustment) only in the third year, and would reach $0 in the fourth year. In the pessimistic scenario, the full $1.5 million, adjusted for inflation, would be needed each year.

Chart 27

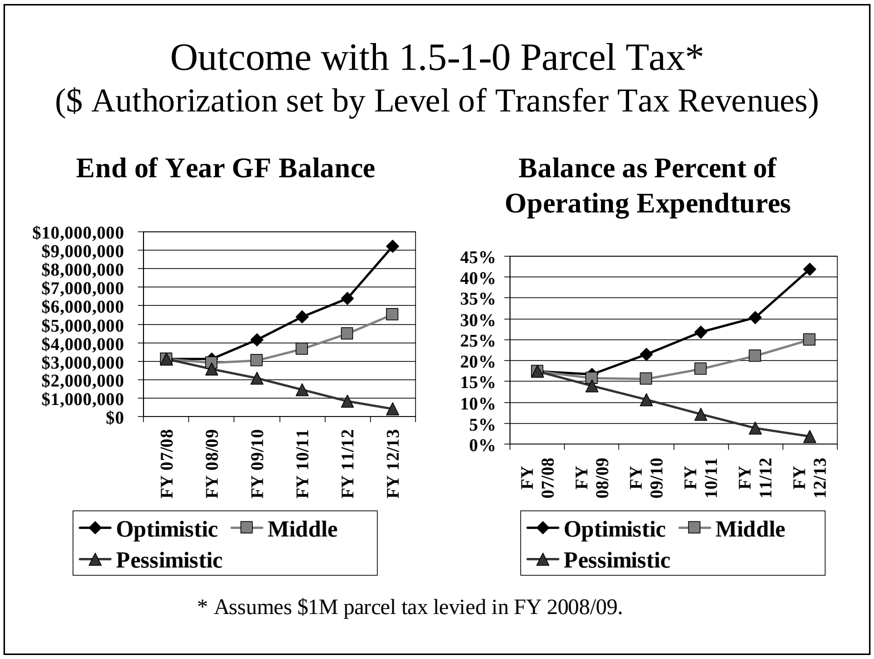
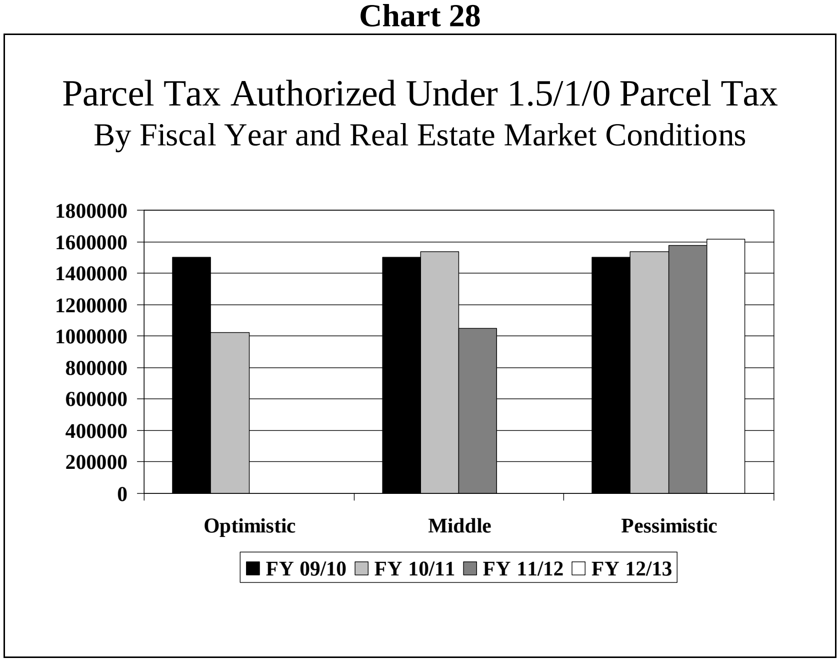


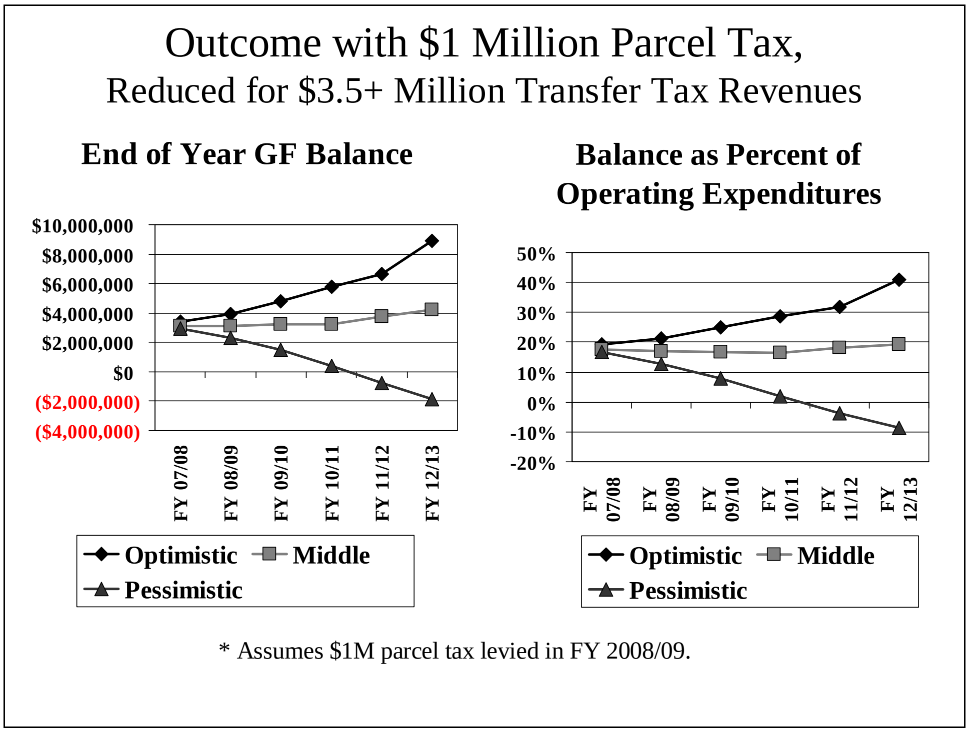
Chart 28



$1 Million Parcel Tax

A $1 million parcel tax would make only minor differences for the optimistic scenario, compared to the $1.5M/$1M/$0 tax, because of the adjustment mechanisms in the $1.5M/$1M/$0 tax. General fund reserves would reach 41%. However, a parcel tax capped at $1 million would make budgeting in poor economic conditions (the pessimistic scenario) much more difficult. Without adjustments to spending, the reserve would drop below 2% by FY 10/11, and projected spending could result in a negative reserve of 8.5% by FY 12/13.

Chart 29



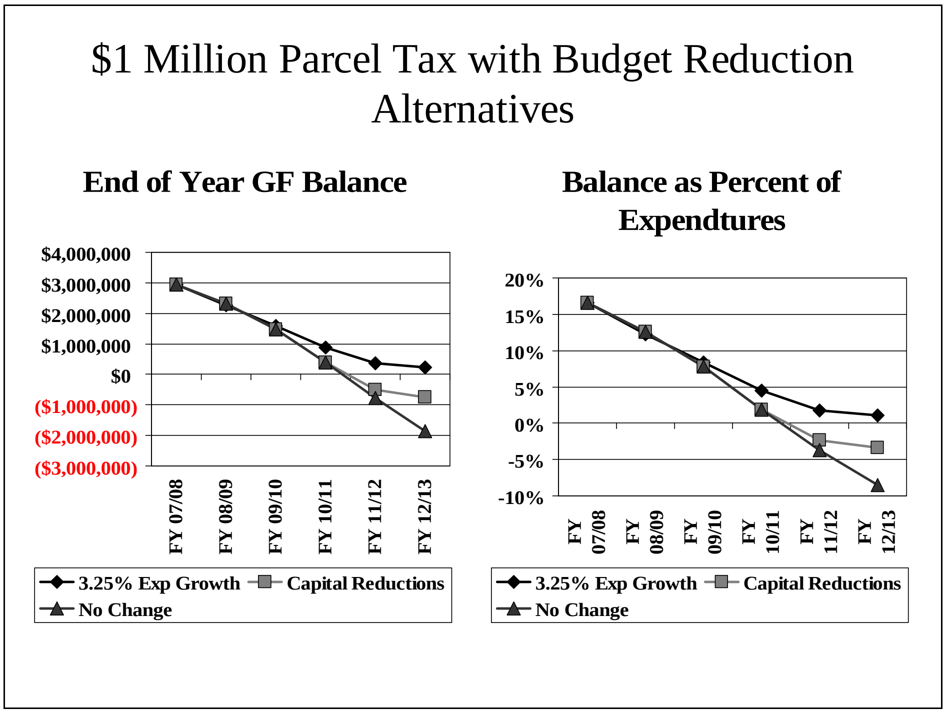
This is a less extreme shortfall than in the no parcel tax case, so we ask the question of whether cuts in capital spending and salary costs could resolve the budget problems in the pessimistic case. While capital expenditure cuts could be made on a year-by-year basis, we should note that the salary cost issue would have to be addressed in negotiations prior to the outset of the period covered by the parcel tax. Chart 30 shows the pessimistic scenario under three different budget strategies:

- No budget adjustment
- Capital spending adjusted through a 10% to 20% drop in transfers out (10% if the general fund end-of-year balance is less than 5%; 20% if the general fund balance is less than 2% of expenditures before transfers out)
- More severe spending restraints, keeping transfers out (including capital spending) to growth of no more than 2.5% per year, and keeping growth in all other expenses

including salaries to 3.25% per year. This is the level of spending that would be required to keep a positive General Fund reserve with a weak real estate market and a $1 million parcel tax levy.

The more severe spending restraints are necessary to bring the budget back into balance under these weak economic conditions, as shown in Chart 30. Even with these restraints, the general fund reserve is below 10% in every year, below 5% by FY 10/11, and below 2% in the following two years, leaving the city with no reserve cushion for an emergency.

Chart 30



Summary of Findings and Conclusions

Our analysis of the Piedmont property market shows that revenues are uncertain. The difference between a strong and weak property market could amount to $2 to $4.5 million annually during the parcel tax period. These uncertainties guide our examination of parcel tax alternatives.

A strategy of no parcel tax would be very risky. With no parcel tax (after a $1 million levy in FY 08/09) and a strong real estate market (the optimistic scenario), the budget would be in balance, with reserves between 19% and 33% of expenditures. With no parcel tax and a weak property market (pessimistic scenario), Piedmont's budget would be in the red by FY 10/11. Conditions would only worsen in later years. Were spending to continue as planned (which it could not) Piedmont would have a negative General Fund ending balance of 27.5% of expenditures by FY 12/13 (assuming $1M parcel tax in FY 08/09).

A $1.5M/$1M/$0 parcel tax would allow the City to maintain the current level of services for the optimistic or moderate real estate market scenarios. The pessimistic real estate scenario leaves the city with a 3.6% reserve in FY 11/12 and a 1% reserve in FY 12/13. Thus, even with a $1.5 million annual parcel tax, some spending cuts would be needed to maintain a prudent General Fund reserve level. With a strong real estate market, reserves would build up to a level above 40%. If this continues, the city would have the luxury of choosing whether to cut other taxes, expand capital expenditures, or take on new amenities for the city, but these would be irrelevant to the parcel tax, which at that point would be restricted to zero.

A $1 million parcel tax would keep result in a positive, healthy reserve with a strong or moderate real estate market. With a weak real estate market, a $1 million parcel tax would require a combination of major capital expenditure cuts and salary constraints. Even with these cuts, the general fund reserve would still be too low.

In making the decision as to which strategy to follow, City Council members may want to review the major uncertainties in costs and revenues that they will face in FY 08/09 and in the FY 09/10 to FY 12/13 period. There are both up side and down side uncertainties, including:

- Higher numbers of sales could improve property-tax and transfer-tax revenues beyond the estimates in the scenarios. Fewer sales than those posited, even if prices rise, could hold down revenue growth.
- The city faces potentially higher costs not included in the analysis. In particular, an increase in the library fee to Oakland is likely, and a decision to include the swimming pool in the range of recreation facilities provided by the city is possible.
- California budget conditions are also being affected by the weak property market. There is the potential for emergency increases in state ERAF takeaways if economic conditions are poor and the state budget deficit remains high.

In conclusion, we find that:

- The decision to eliminate the parcel tax could lead to serious economic difficulties in a weak real estate market and to very tight budget conditions in a moderate market.
- In a weak real estate market, a $1 million parcel tax would require the city to make significant cuts in capital and operating expenditures to avoid a deficit. The reserve would still be inadequate.
- A $1.5 Million/$1 Million/$0 parcel tax would give the city the resources to provide services at the current level in all but the weakest economic conditions and to respond to weak conditions with moderate rather than extreme cuts. The tiered parcel tax structure would at the same time provide some restraint on assessment levels if economic conditions are strong.

We recommend that the Council place a parcel tax authorization of $1.5 million on the ballot, with a tiered structure such as that described here and the ability to restore some parcel tax reductions in the event of the growth in ERAF takeaways.

MUNICIPAL SEWER TAX

This section gives background on Piedmont's Municipal Sewer Tax. The City is currently in compliance in terms of required sewer repairs and is undergoing explorations to determine the condition of the remaining, original clay pipes. Preliminary findings indicate that the City should continue with a plan to replace all remaining lines, funded by the continuation of the sewer tax and borrowing on favorable terms from the state. Financing scenarios suggest that the sewer tax needs to be levied at its maximum rate, including inflation adjustment, so that adequate funds will be available. To date, Piedmont has spent about $8.5 million on sewer rehabilitation, out of the $17 million projected as the total cost of the project.

BACKGROUND OF CEASE & DESIST

The service area of Piedmont's sewer system set the City's original 1907 boundaries. Within Piedmont's 1.8 square miles, approximately 50 miles of public and 25 miles of private sanitary sewer lines collect wastewater. Most of these lines were built during the period from 1900 through the 1940s.

Separate systems of storm drains and sanitary sewers were designed to handle ground water and sewage. Piedmont's sewage flows through the City of Oakland to the East Bay Municipal Utility District's (EBMUD) Water Pollution Control Plant. There it joins with wastewater from other East Bay cities for treatment. After primary and secondary treatment cleans the water, it is discharged into the San Francisco Bay.

Underground pipes are imperfect, allowing rain and ground water to intrude into the sanitary sewers instead of the storm drains. Most ground water infiltration into the sanitary sewers comes from Piedmont's 60- to 100-year-old sewer mains and feeder lines made of vitreous clay. The old pipes have cracked, the joints have loosened, and sections have been separated by tree roots or ground movement. During heavy rains, the total volume in the sanitary sewers can be as much as 10 times higher than during the dry summer months, with ground water infiltration accounting for the additional flow. Even if the sewers don't overflow locally, the East Bay Municipal Utility District's Pollution Control Plant can be overwhelmed, resulting in untreated sewage infiltrating the Bay. These sewage overflows constitute a public health and environmental hazard and violate environmental laws.

To resolve these problems, in 1986 the California Regional Water Quality Control Board (CRWQCB) issued a Cease and Desist (C&D) order to Piedmont and six other East Bay communities. The C&D required the amount of ground water entering the sewage system to be reduced enough to virtually eliminate overflows of untreated wastewater. A 1993 amendment to the C&D included a detailed Compliance Plan. In this Plan, Piedmont identified specific areas where sewer line repairs and upgrades could achieve the required ground-water reductions. The Compliance Plan also required regular annual reports, so that the Regional Water Quality Control Board could be assured that Piedmont met its June 30, 2014 completion deadline.

Piedmont had several responsibilities under the C&D: reducing ground water infiltration; eliminating local overflows by increasing the capacity of "bottleneck" sewer mains; and paying its fair share of the cost to upgrade the main lines feeding EBMUD's treatment plant. Engineering studies indicated that Piedmont could achieve its ground water reduction target by fixing nine of its 21 sub-basin areas.[16]

TIMETABLE FOR COMPLYING WITH CEASE & DESIST

The City adopted an accelerated approach to complete the nine sub-basins included in the C&D, which proved to be a wise move. The sewer-main replacements were completed in three phases by 2005, nine years ahead of the C&D deadline in 2014. The shortened timeframe benefited the City in several ways:

- Larger capital projects provided contractors with economies of scale and allowed Piedmont to increase bidding competition.
- The favorable funding program from the State proved very attractive, with rates at 2.42%, lower than any other financing source.

PIEDMONT'S SEWER TAX

Every city in the East Bay imposes sewer charges on its residents. Piedmont's first sewer tax passed in December 1958. In 1986, a monthly charge of $16.50 per connection ($198 per year) was enacted. Single-family homes, apartment units, and commercial properties were each considered as a separate connection.

Piedmont's Municipal Sewer Tax pays for operating and maintenance expenditures and for debt service on capital improvements for both the sewer and the storm drain systems. The Municipal Sewer Tax consists of a fixed base rate per hookup, plus a variable charge based on the same lot-size categories as the parcel tax. This approach has been efficient to administer and has the added virtue of being generally understood and accepted by most residents.

In the March 2000 election, the voters passed a sewer tax increase of over 120% by one of the largest "yes" votes (76%) in the City's history and a provision allowing an annual rate adjustment based on changes in inflation. As a result, the annual average sewer tax increased $243, from $198 for FY 97/98 to $441 for FY 01/02.

In FY 06/07, Piedmont's average sewer tax was about $450 and totaled $1.75 million. For FY 07/08, Table 18 shows the options considered by the Council: the maximum authorized rate, the proposed rate (including a CPI adjustment) and the current 06/07 rate. The "Current Rate" from FY 06/07 was adopted by the Council for FY 07/08 (in other words, the tax will be levied at FY 06/07 rates for FY 07/08, with no CPI adjustment).

Table 18

FY 07/08 Sewer Tax Rate Discussions: Proposed, Maximum and Adopted					
Parcel Size in square feet	Base Year FY 01/02	Maximum Rate FY 07/08	Proposed Rate FY 07/08 CPI: 3.44%	Current Rate FY 06/07	Adopted Rate FY 07/08
Single Family Residences					
0 to 4,999	$379	$433	$401	$388	$388
5,000 to 9,999	$432	$494	$459	$444	$444
10,000 to 14,999	$498	$569	$528	$510	$510
15,000 to 20,000	$581	$664	$617	$596	$596
Over 20,000	$684	$782	$726	$702	$702
Commercial Properties					
0 to 10,000	$684	$782	$726	$702	$702
Over 10,000	$942	$1,077	$1,000	$967	$967
Multi-family residential: per unit	$316	$361	$336	$325	$325
Dual jurisdiction: per parcel	$379	$433	$401	$388	$388

Source: *City of Piedmont, Council Agenda Report. June 11, 2007*. Mark Bichsel, Finance Director.

FY 07/08 is not the first time that the Council has not levied the full amount of the authorized tax. Table 19 shows the maximum sewer rate, the actual rate, and the implied cumulative rates. Had the maximum rate been levied every year since the FY 01/02 base year, the cumulative increase would have been 14.3% instead of 6.2%.

Table 19

Piedmont Sewer Parcel Tax Rates		
	Maximum Rate Of Increase	Actual Rate Of Increase
FY 01/02 (Base Year)		
FY 02/03	3.50%	3.50%
FY 03/04	1.40%	1.40%
FY 04/05	1.10%	-5.50%
FY 05/06	2.15%	2.15%
FY 06/07	1.95%	1.38%
FY 07/08	3.44%	0.00%
Cumulative Rate	14.30%	6.24%

Source: City of Piedmont

DECIDING WHICH SEWER LINES TO REHABILITATE FIRST

The 1986 C&D order and Sewer System Evaluation Survey Report examined all 21 sub-basins in the City of Piedmont. The map in Appendix D, Exhibit 2, depicts the City's sub-basins as of April 2007. The first nine sub-basins (Phases I, II and III) were selected for rehabilitation by conducting various field investigation techniques such as smoke testing, flow monitoring, CCTV inspection, and manhole inspection. A cost-effectiveness (C/E) analysis provided a way to rank the sub-basins. The C/E ratio is defined as a ratio of two costs:

$$\text{C/E Ratio} = \text{(Cost of Treating Wet Weather Flows) / (Cost of Reducing Flow within a Sub-basin)}$$

Table 20 shows the ranking of the 21sub-basins that resulted from the 1986 study. For Phase IV sub-basins, TV camera exploration was finished in 2005, the Council has given its approval to go ahead with the project, and the work will begin as soon as the financing is in place. Currently, the sub-basins in Phases V, VI and VII are being evaluated by TV camera exploration. Ten percent of the remaining clay pipes will be evaluated by October 2007, with the remaining 90% to be completed by early 2008. To update the City on progress with sewer rehabilitation, a consulting group, Harris & Associates, submitted a report to the City Council on July 17, 2006: *City of Piedmont Sanitary Sewer Rehabilitation Program*. When Phase IV is finished, 67% of the sewers will have been rehabilitated (see Table 21).

Table 20

Ranking of 1986 C/E Ratios for 21 Sub-Basins* in Piedmont

C&D Order:	1986 Rank	Sub-Basin	C/E Ratio		1986 Rank	Sub-Basin	C/E Ratio
1995	1	G1	2.95	Phase IV, Ongoing Project (2006-2007)	10	G3	0.96
Phase II	2	F1	2.78		11	G5	0.93
Phase II	3	W7	2.57		12	N2	0.89
Phase II	4	N1	1.57		13	T2	0.82
Phase III	5	W5	1.55		Future Rehabilitation		
Phase I	6	G4	1.44	Phase V	14	G6	0.79
Phase II	7	W4	1.27		15	V1*	0.72
Phase I	8	W1A	1.24		16	G2	0.70
Phase II	8	W1B	1.24	Phase VI	17	G7	0.65
Phase III	9	T1	1.07		18	W2	0.63
Dates: Phase I (2001-2002)				Phase VII	19	H1	0.60
Phase II (2002-2003)					20	W6	0.51
Phase III (2004-2005)					21	W3	0.31

Source: Harris & Associates, *City of Piedmont Sanitary Sewer Rehabilitation Program*, July 17, 2007 and Revised Map, April 2007.
* Note: In 1986, Piedmont was divided in 22 basins. Two of the original basins (G5 and N2) have since been merged into V1.

Table 21

Sanitary Sewer (SS) Rehabilitation Summary, July 2006			
	Linear Footage Rehabilitated	Share Rehabilitated	Cumulative Rehabilitated
1995 + Phases I, II, and III + Miscellaneous SS work	142,067	54%	54%
Phase IV	33,400	13%	67%
Phases V, VI and VII	102,150	33%	100%
Total	277,617	100%	

EVALUATING AND PAYING FOR SEWER REHABILITATION

Three financing methods are generally considered for financing the rehabilitation of Piedmont's sewers: (1) sewer parcel tax (pay-as-you-go), (2) utilizing favorable state financing programs for sewer replacements, and (3) issuing municipal bonds. Piedmont plans to finance Phases IV, V, VI and VII of the sewer rehabilitation project with sewer parcel-tax revenues and as much state financing as possible. Bond finance for sewers is currently not under discussion. If at some point, state financing is not available for the remaining phases, Piedmont plans to proceed at a slower pace using sewer-tax funds.

The State of California serves as a conduit for federal subsidies to cities to finance capital costs for sewer rehabilitation projects. California currently has about $400 million in its revolving subsidized loan fund, with two fixed-rate loan programs. The financing program chosen by the City allows it to borrow at one-half the State's current cost for general-obligation bonds. The current rate under the special program is 2.42%. A loan application was filed with the State Water Resources Control Board in May 2007 for $3.5 million to rehabilitate the four sub-basins known as Phase IV.

Recent evaluation of sewer system has shown numerous defects: collapsed pipes, displaced joints, root intrusion. For the sub-basins in Phase V, VI and VII, a camera exploration of 10% of the pipes in each sub-basin was undertaken in order to give the Committee some information on which to base this report. The plan was to finish the 10% sample by summer 2007. However, that process has been slowed down considerably because the crew can't even get the TV camera through many of these pipes. As a result, the sewer maintenance crews have been doing point repairs to get the pipes clear enough so the TV camera can take accurate pictures. This suggests that all clay pipes are most likely in need of replacement in all remaining sub-basins. This is not surprising because the pipes are 60 to 100 years old throughout the system. The camera exploration of 100% of the pipes is expected to be completed by early 2008.

It should be noted that on-going maintenance expenses for sewers will increase, especially for the old pipes. New guidelines from the State of California Clean Water Program suggest foaming or rodding of 25% of the pipes in the system each year. This means that every four years the entire system will be checked. Foaming is very expensive…this is what has to be done on old, original clay pipes. Rodding can be done on rehabilitated, plastic pipes and is much less expensive.

Table 22

Financing and Evaluation Summary for all Phases of Sewer Rehabilitation		
	Financing	**Evaluation**
1995 + Phases I, II, and III	Federal grant + state loan program at 2.3%, 20-year term	1986 Study for C&D
Phase IV	City has submitted a $3.5m loan application to the SWRCB. City expects to hear in ~Oct. 2007.	TV Camera Exploration: 100% of pipes, 2005
Phases V, VI and VII	City plans to submit additional loan applications to the SWCRB for each phase.*	TV Camera Exploration: 10% sample of pipes, to be completed by October 2007; 100%, completed by early 2008

SEWER TAX SCENARIOS, FY 2008/09 THROUGH FY 2019/20

The Committee considered five scenarios for future development of the sewer fund through 2020 depending on assumptions for sewer service charges, interest revenues, expenditures (both operating and emergency) and how many phases are completed. Table 23 outlines the scenario assumptions used. All scenarios use the same increase in interest revenue (4%). These scenarios were run for two expenditures options: (1) operating expenditures increasing at 3% per year and (2) increases at 5%.

- Scenarios #1, #2, and #3 levy the full amount of the sewer tax in FY 08/09 and differ only by the amount of the CPI adjustment.[17]
  - Scenario #1 assumes the future CPI adjustment is 2% per year.
  - Scenario #2 assumes a CPI adjustment of 3%.
  - Scenario #3 does not levy any CPI adjustment across the years.
- Scenario #4 (the most pessimistic) decreases the sewer tax by 5% in FY 08/09 and does not include a CPI adjustment in the future.
- Scenario #5, like Scenario #3, levies the full amount of the sewer tax in FY 08/09 but does not include a CPI adjustment. Scenario #5 also assumes expenses are flat over time.

Table 24 shows the implications of each scenario on the ending sewer fund balance. These projections were run assuming the City completes through Phase IV (on-going), V, VI or VII. For both operating expenditure options (3% and 5%), the table shows the ending fund balance and the year that the ending fund balance would be negative (if applicable). The table suggests that for each one percentage point increase in operating costs, the added cost over the life of the project is about $1 million. The negative fund balances (which mean the sewer fund has run out of money) for most of these scenarios by Phase VII suggest that additional funding may be needed in the future to finish the project. The most pessimistic scenario, #4, shows negative fund balances in much earlier phases of the project.

Table 23

Assumptions for Five Sewer Fund Scenarios					
Scenario:	#1	#2	#3	#4	#5
Sewer service charge (sewer tax)	+2%	+3%	No increase	-5% in 08-09, then flat	No increase
Interest revenue	+4%	+4%	+4%	+4%	+4%
Operating Expenses	A: +3%	+3%	+3%	+3%	No increase
Two options: A & B	B: +5%	+5%	+5%	+5%	No increase
Emergency capital cost	+3%	+3%	+3%	+3%	No increase
Inflation adjustment	CPI 2%	CPI 3%	CPI 0%	CPI 0%	CPI 0%

Table 24

Ending Fund Balance for the Sewer Fund ($ millions), FY 2019/20					
Scenario:	#1	#2	#3	#4	#5
3% option: operating expenses increase at 3% per year					
Phase IV	$4.9	$6.8	$1.5	$0.2	$5.0
Phase V	$2.3	$4.2	($1.1)	($2.4)	$2.4
Phase VI	$0.6	$2.5	($2.8)	($4.1)	$0.6
Phase VII	($0.6)	$1.3	($4.0)	($5.3)	($0.6)
3% option: Year the Sewer Fund Goes Negative:					
Phase IV					
Phase V			2018	2016	
Phase VI			2016	2014	
Phase VII	2018		2015	2014	2018
5% option: operating expenses increase at 5% per year					
Phase IV	$2.9	$4.8	($0.5)	($1.8)	$5.0
Phase V	$0.3	$2.2	($3.1)	($4.4)	$2.4
Phase VI	($1.4)	$0.5	($4.8)	($6.2)	$0.6
Phase VII	($2.6)	($0.7)	($6.0)	($7.4)	($0.6)
5% option: Year the Sewer Fund Goes Negative:					
Phase IV			2019	2017	
Phase V			2016	2014	
Phase VI	2017		2014	2013	
Phase VII	2016	2018	2014	2013	2019
Source: City of Piedmont. All scenarios assume Piedmont receives state funding at favorable rates for all phases of sewer rehabilitation.					

Under Scenario #1, for example, if the City were to complete through Phase VII, the ending fund balance in FY 2019/20 would be negative $0.6 million if expenses were to increase at 3% per year. These trends are shown for Phases IV, V, VI and VII in Charts 31 and 32.

Chart 31

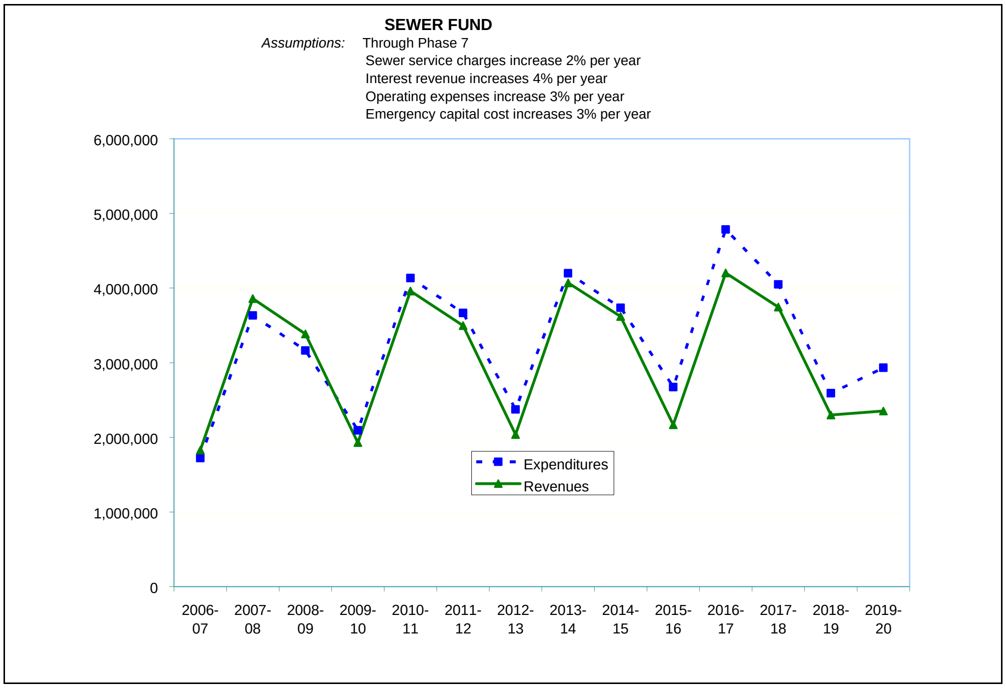
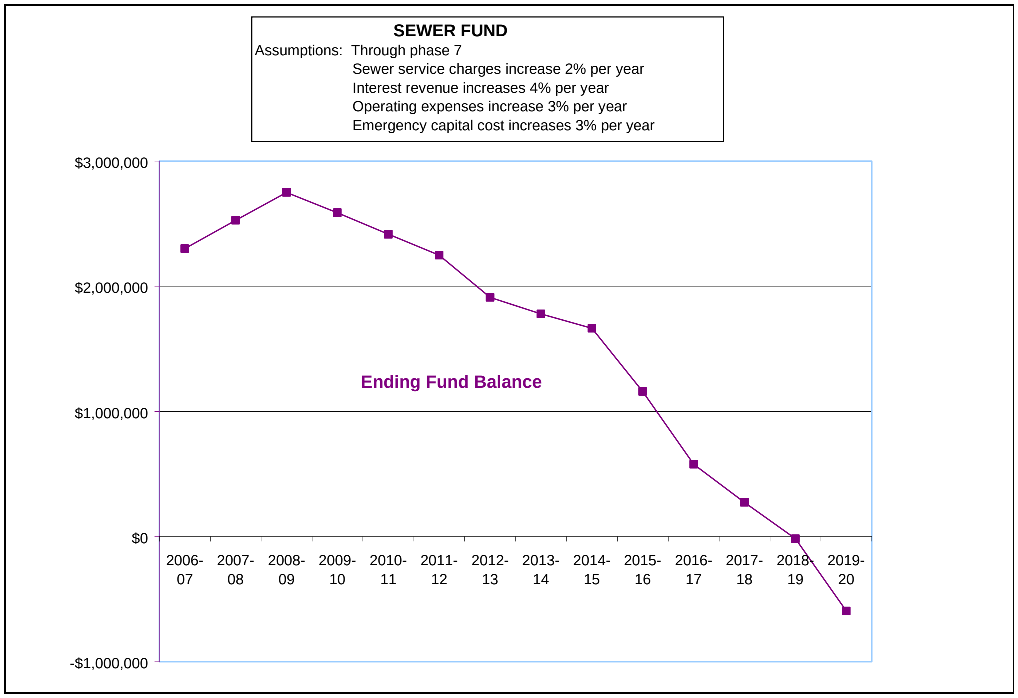


Chart 32



THE CASE FOR CONTINUING SEWER MAIN REPLACEMENTS

In summary, the Committee believes the City should continue with sewer rehabilitation program for the following reasons:

- Reduce sewer overflows
- Better pipe material/construction technique
  - Plastic pipes will replace old clay pipes
  - Seismically stable, flexible
  - 100-year life expectancy for plastic pipes
- Minimize homeowner damage claims
- Reduce emergency repair work
- Reduce on-going maintenance budget (to prevent further root intrusion, decrease the number of pipes needing foaming and increase the number of pipes needing rodding)
- Increase public safety and lessen impact on the environment.
- Take advantage of favorable state financing
- Equity – All original clay sewer pipes in Piedmont are old and all residents have been paying the sewer tax for rehabilitation. All original sewer lines need to be replaced.

At this point, the major unknowns in the process are:

- Current bidding climate
- Availability of state financing (As of September 2007, Piedmont has still not heard the outcome of its state grant application.)

Recommendation #4:

The City should plan to rehabilitate all the old clay sewer pipes in Piedmont. This would involve levying the Sewer Tax at the maximum rate for the next five years, including inflation adjustment, and pursuing state financing.

THE 2011 MUNICIPAL TAX REVIEW COMMITTEE

Recommendation #5:

In 2011, a Municipal Tax Review Committee should be appointed by the Council to review both the Parcel Tax and the Sewer Tax, and to make recommendations to the Council. We recommend that there be at least seven members to this Committee, that the review process start in January 2011, and that the Council provide some resources to the Committee for the report to be written. This might include clerical support from City staff or, alternatively, hiring a consultant.

APPENDIX A: PROPOSITIONS 13, 218, 1A AND ERAF

PROPOSITION 13 LIMITATIONS

The passage of Proposition 13 in 1978 severely restricted cities' ability to levy property taxes, generally limiting the property tax rate to 1% of assessed value.[18] The assessed value cannot exceed its fair market value and is further limited depending upon whether there has been a change of ownership:

- For properties that have not undergone a change of ownership since 1975, the assessed value is the 1975 assessed value increased by an inflation factor capped at 2% per year.
- For properties that have undergone a change of ownership, the assessed value is the fair market value of a property after the most recent change of ownership increased by the inflation factor capped at 2% for each year since the change of ownership.

Since the passage of Proposition 13, the Legislature has had the power to reallocate property taxes among local governments and school districts. The most significant use of this authority has been to allocate city, county and special district shares of the property tax to schools through three major property tax shifts and reduce state general fund support for schools. These property tax shifts began in 1992.

One effect of Proposition 13 is that assessed values often remain far below market values. By holding down property valuations, Proposition 13 has greatly limited property tax revenues. Since properties are reassessed only when they change ownership, property tax revenues can increase rapidly when many properties are changing hands. Slow turnover, on the other hand, leads to under-assessed properties and stagnant tax revenues. Piedmont has a slower turnover rate and an older age profile of homeowners than the state as a whole.

ERAF: STATE TAKEAWAYS FROM THE CITY

The City of Piedmont does not benefit as much as might be expected from its comparatively high property values. The City receives less than 30% of the total property taxes collected from Piedmont residents.

One reason the city's property tax revenues are such a small share of the total amount paid by its residents is because of state takeaways. In FY 92/93 and FY 93/04, the State of California had serious budgetary shortfalls. To meet its obligations to fund education at levels specified under Proposition 98, the state shifted $1.3 billion in local property revenues from counties, cities, special districts and redevelopment agencies to schools and community colleges.[19] County auditors were instructed to shift $1.3 billion from local government to a special fund entitled "ERAF," the Educational Revenue Augmentation Fund. Since 1992, the Legislature has implemented three ERAF shifts: I, II and III.

According to analysis by the League of California Cities, in FY 07-08, the annual impact of ERAF is a shift of about $7.3 billion away from cities, counties and special districts. Cumulatively, since their inception, ERAF shifts have deprived local governments of over $72.4 billion. Counties have borne some 74% of this shift; cities have borne 16%.[20]

The state has provided some funding to local governments that it considers mitigation of ERAF. The League of Cities finds that:

> The vast majority of these funds are earmarked for particular purposes. Moreover, a relatively small portion of the funds has gone to cities. In 1992, California voters approved Proposition 172, which provided sales tax funding for police, fire and other public safety programs. Prop 172 funds provide only $3 billion annually to local government, leaving local citizens facing a $4.3 billion net ERAF gap in FY 07-08. Considering all state subventions that the Legislative Analysis defines as "ERAF" mitigation," the net ERAF impact on cities is nearly $800 million in the current year.

In 2003, the state was struggling with large budget deficits and many cities were worried about the prospect of another state raid on local funds.[21] As part of the budget agreement that put Proposition 1A of 2004 on the ballot to protect city revenues from additional shifts and state takeaways, cities, counties and special districts agreed to contribute an additional "ERAF III" shift of $1.3 billion per year in FY 04/05 and FY 05/06. The ERAF III shift ended in FY 06/07. Proposition 1A protects major city revenues from additional shifts, but did not reduce the on-going ERAF I and II shifts begun in 1992-94.[22]

PROPOSITION 1A

In November 2004, California voters overwhelmingly approved Proposition 1A, an amendment to the state constitution intended to restore predictability and stability to local government budgets. Prop 1A was passed by an unprecedented 84% yes vote. Prop 1A has provisions for strengthening prohibitions against unfunded state mandates, expanding the definition of a state mandate, and strengthening local revenue protections.[23] Prop 1A does not provide local governments with any new revenue nor reduce or alter the ERAF I and II shifts. Concerning local revenue protection, the measure prohibits the state from:

- Shifting property taxes from cities, counties or special districts, with certain exceptions.
- Reducing the local sales tax rate or altering its method of allocation, except to comply with federal law or an interstate compact.
- Decreasing vehicle license fee (VLF) revenue from the 0.65% rate without providing replacement funding to cities and counties.

The basic protection for the property tax in Prop 1A is that the Legislature cannot reduce the combined property tax shares of cities, special districts and counties. If, for example, on November 3, 2004, the property tax shares of Alameda County's cities, special districts and the county itself equaled 60% of property taxes collected in the county, the Legislature cannot pass a law that reduces the percentage below 60% except to respond to a significant state fiscal problem. Prop 1A prevents future reductions of non-school property tax shares, but the state may still transfer property taxes among the cities, county and special districts within a county with a two-thirds vote of the legislature. The state cannot reallocate property taxes in order to fund a state mandate.

What if there's a significant state fiscal problem? Beginning in FY 08-09, the Legislature may "borrow" not more than 8% of total property tax revenues (currently about $1.3 billion) under certain conditions. The Governor must issue a proclamation declaring that there is a "severe state fiscal hardship" that requires the state to temporarily suspend Prop 1A's basic protection for the local property tax. Next, the Legislature must first adopt a statute with a two-thirds vote that contains a suspension of the basic protection for that fiscal year only. Then it must adopt a separate statute that requires the state to repay cities, counties and special districts the total amount of property-tax loss caused by the suspension. The Legislature may not enact such a suspension more than twice in any 10-year period, and local agencies must be repaid (the borrowed funds plus interest) within three years.

Prop 1A language does not contain the provision for the ERAF III local government contributions. This was part of the State Budget Act of 2004.

PROPOSITION 218 LIMITATIONS

Although Proposition 13 is the best-known tax limitation in the country, Proposition 218, passed by the voters in 1996, created a comprehensive tax-limitation scheme to augment Proposition 13. Proposition 218 imposed more limitations (and clarified prior limitations) on a local government's ability to use special taxes, assessments and fees. Under Proposition 218, a special tax is any tax imposed for specific purposes, including a special tax imposed even though the proceeds from the tax go into a general fund. Thus, Proposition 218 required that a parcel tax should have stated "special purpose," even if the revenues are placed in a general fund. Special taxes can be either general (placed in the General Fund for any purpose) or specific (targeted to specific purposes as described in the election ballot).

The Piedmont Unified School District's parcel tax has historically been a specific tax; the city's Municipal parcel tax has historically been a general tax. Whether the city tax should continue to be a general tax or whether it should be changed to a specific tax has been debated by this Committee.

Both Proposition 13 and Proposition 218 made clear that special taxes and tax increases require a super-majority: a two-thirds vote of the electorate. The League of Cities keeps a database of local tax elections.[24] As of Fall 2006, the data include information from 307 cities and 666 measures. The elections were held from 1991 to 2006, distributed across the years as follows: 1991 (1 election), 1996-2000 (249 elections), 2001-2006 (414 elections), date missing (2 elections). Table A.1 shows the type of taxes voted on, by whether they passed or failed.

Parcel-tax elections such as Piedmont's are included in the "miscellaneous" category. The type of tax least likely to pass is libraries (34% of library measures pass); miscellaneous taxes are the second least likely. The types of taxes voted on most frequently are utility, hotel/TOT, and police/fire.

There is an obvious asymmetry in the way Proposition 218 works: to decrease or eliminate a tax a city council need only take a majority vote, but a tax increase requires a two-thirds majority of the voters. The practical implications of 218 for Piedmont rippled through many of the Committee's deliberations: if business license tax rates were decreased, for example, they could not be increased back to the previous level without an election and a two-thirds majority. Similarly with transfer tax rates. This asymmetry and lack of flexibility clearly limits options for cities. Cities cannot decrease tax rates in good financial times and then raise them back again in times of economic downturn without going to the electorate for two-thirds approval.

Table A.1

California Municipal Tax Measures, by Tax Type and Measure Pass Rate, 1991 and 1996-2006

Type of Tax Measure	Passed	Failed	Missing data	Total	% Pass
Water/sewer	4			4	100%
Admissions	4	1		5	80%
Business License	36	12	1	49	73%
Hotel/Transient Occupancy Tax (TOT)	78	38	1	117	67%
Lighting/Landscape	28	14	1	43	65%
Police/Fire	62	34		96	65%
Parking	3	2		5	60%
Parks/Recreation	16	11		27	59%
Local Option Sales Tax	45	33	2	80	56%
Utility	69	73	2	144	48%
Miscellaneous	30	33	1	64	47%
Library	11	21		32	34%
Total	386	272	8	666	58%

Source: California League of Cities and Committee calculations.

APPENDIX B: REVENUE COMPARISONS

The structure of Piedmont's revenue sources differ substantially from those of the average California city. This section compares revenue figures across cities using data from the State Controller, *Local Annual Reports, FY 2003/04*. These numbers vary somewhat from City numbers because the categories and definitions used differ. For example, the State Controller's "General Purpose Revenue" is not the same as the City's "General Fund Revenue." In Table B.1, comparisons are first done on a per capita basis, and second as a percentage of General Purpose Revenues.

- On a per capita basis, Piedmont ranks fairly high for most taxes it collects because it has high property values and low population density. Piedmont stands out with respect to transfer taxes: the city ranks second in the state on a per capita basis (collecting $267 per capita) and first in the state as a percentage of general purpose revenues (22%). This is not surprising given Piedmont's high property values and the fact that its city transfer tax rates of 1.3% are the second highest in the state (see also Table B.2).
- Piedmont also ranks high with respect to per capita property tax revenues ($597 per capita, eighth in the state) and property taxes as a percentage of general purpose revenues (49%, 19th in the state).
- On a per capita basis, Piedmont collected above the state median for both utility user and business license taxes. As a percentage of general purpose revenues, however, Piedmont was below the state median for utility user taxes (Piedmont 7%, state 15%) and equaled the state median for business license taxes (both 3%).
- Piedmont had almost no sales tax, collecting only $15 per capita compared with a state median of $129. Piedmont does not levy a transient occupancy tax.
- Piedmont's two largest revenue sources, property and transfer taxes, accounted for about 70 % of general purpose revenues. Statewide, the median for property taxes was 20%; transfer taxes, 1%; and sales and use taxes, 31%.
- Since the City has a relatively small population, Piedmont's ranking among other cities for tax revenue amounts is relatively low. The exception is real property transfer tax revenue. In FY 03/04, only 17 cities in the state collected more transfer tax revenue than Piedmont. All were chartered cities with much larger populations than Piedmont (see Table B.3).

Table B.1

Piedmont's Revenue Ranking Among Cities (1) on a Per Capita Basis and (2) as a Percentage of General Purpose Revenues

FY 03/04, For All Cities[1]	Per Capita				Tax Revenues as a % of General Purpose Revenues			
			Median ($)				Median (%)	
	Rank: Pied-mont	Num-ber of Cities	Pied-mont	State	Rank: Pied-mont	Num-ber of Cities	Pied-mont	State
General Purpose Revenues	24	469	$1,210	$544	NA	NA	NA	NA
Taxes:								
Property	8	467	$597	$76	19	463	49%	20%
Transfer	2	442	$267	$6	1	443	22%	1%
Utility User	45	147	$90	$65	131	146	7%	15%
Business License	55	436	$32	$10	206	433	3%	3%
Sales and Use	458	468	$15	$129	463	464	1%	31%
Transient Occupancy	NA	391	NA	$13	NA	388	NA	3%

[1]All cities reporting data. There were 478 cities in California in FY 03/04. Data reporting to the State Controller is not complete. In FY 03-04, six cities, including three full-service cities (Richmond, Imperial and Sierra Madre), did not report general purpose revenues.

Source: Computations by CaliforniaCityFinance.com and by the Committee from two data sources: State Controller, *Cities Annual Report*, FY 2003/04 and the Department of Finance.

Transfer Tax Rates:

Real property transfer taxes are levied on movers. In Alameda County, half of the tax is paid by the buyer and half by the seller. Transfer tax rates have two components: a city rate and a county rate. In almost all general-law cities and most charter cities, both rates are $0.55 so the total amount charged (city + county rate) is $1.10. In some counties, rates are $1.10. In 2007, 23 cities charged a city transfer-tax rate other than $0.55 per $1,000 property value. All of these 23 cities charged a county rate of $1.10. Oakland and Berkeley had the highest rate in the state ($15 per $1,000 property value, or 1.5%) and Piedmont's rate was second highest ($13, or 1.3%). Note that Piedmont's rate was doubled to 1.3% in October 1993.

Table B.2

Real Property Transfer Tax Rates, 2007

	City	County	Chartered/ General Law	City Rate	County Rate	Total Rate
				Rate Per $1,000 property value		
1	Berkeley	Alameda	Chartered	$15.00	$1.10	$16.10
2	Oakland	Alameda	Chartered	$15.00	$1.10	$16.10
3	**Piedmont**	**Alameda**	**Chartered**	**$13.00**	**$1.10**	**$14.10**
4	Albany	Alameda	Chartered	$11.50	$1.10	$12.60
5	Richmond	Contra Costa	Chartered	$7.00	$1.10	$8.10
6	San Leandro	Alameda	Chartered	$6.00	$1.10	$7.10
7	Alameda	Alameda	Chartered	$5.40	$1.10	$6.50
8	Hayward	Alameda	Chartered	$4.50	$1.10	$5.60
9	Culver City	Los Angeles	Chartered	$4.50	$1.10	$5.60
10	Los Angeles	Los Angeles	Chartered	$4.50	$1.10	$5.60
11	Mountain View	Santa Clara	Chartered	$3.30	$1.10	$4.40
12	Palo Alto	Santa Clara	Chartered	$3.30	$1.10	$4.40
13	San Jose	Santa Clara	Chartered	$3.30	$1.10	$4.40
14	Vallejo	Solano	Chartered	$3.30	$1.10	$4.40
15	Santa Monica	Los Angeles	Chartered	$3.00	$1.10	$4.10
16	Pomona	Los Angeles	Chartered	$2.20	$1.10	$3.30
17	Redondo Beach	Los Angeles	Chartered	$2.20	$1.10	$3.30
18	San Rafael	Marin	Chartered	$2.00	$1.10	$3.10
19	Petaluma	Sonoma	Chartered	$2.00	$1.10	$3.10
20	Santa Rosa	Sonoma	Chartered	$2.00	$1.10	$3.10
21	Riverside	Riverside	Chartered	$1.10	$1.10	$2.20
22	Winters	Yolo	General Law	$1.10	$1.10	$2.20
23	Woodland	Yolo	General Law	$1.10	$1.10	$2.20

Source: CaliforniaCityFinance.com, http://www.californiacityfinance.com/PropTransfTaxRates.pdf

Transfer Tax Revenues ($ Amount)

Since Piedmont's population is relatively small, Piedmont's ranking among other cities for tax and revenue amounts is relatively low. The exception is real property transfer-tax revenue. In FY 03/04, only 17 cities in the state collected more such revenue than Piedmont. All were chartered cities with much larger populations.

Table B.3

Rank	City	County	Transfer Tax FY 03/04	Population 1/1/2004
1	Los Angeles	Los Angeles	$159,244,212	3,912,244
2	San Francisco	San Francisco	$78,845,357	792,690
3	Oakland	Alameda	$49,847,434	411,609
4	San Jose	Santa Clara	$29,413,304	926,241
5	Sacramento	Sacramento	$13,188,000	440,976
6	San Diego	San Diego	$10,562,132	1,294,032
7	Berkeley	Alameda	$10,460,385	104,279
8	Hayward	Alameda	$6,868,993	144,633
9	San Mateo	San Mateo	$6,712,963	93,050
10	Palo Alto	Santa Clara	$5,598,000	60,246
11	Santa Monica	Los Angeles	$5,349,788	90,321
12	San Leandro	Alameda	$5,106,985	81,489
13	Santa Rosa	Sonoma	$4,181,610	154,379
14	Vallejo	Solano	$4,042,369	121,085
15	Riverside	Riverside	$3,662,236	277,030
16	Alameda	Alameda	$3,244,257	74,409
17	Mountain View	Santa Clara	$3,065,106	71,616
18	**Piedmont**	**Alameda**	**$2,953,530**	**11,067**

Source: State *Controller Cities Annual Report, 2003/04* and CaliforniaCityFinance.com

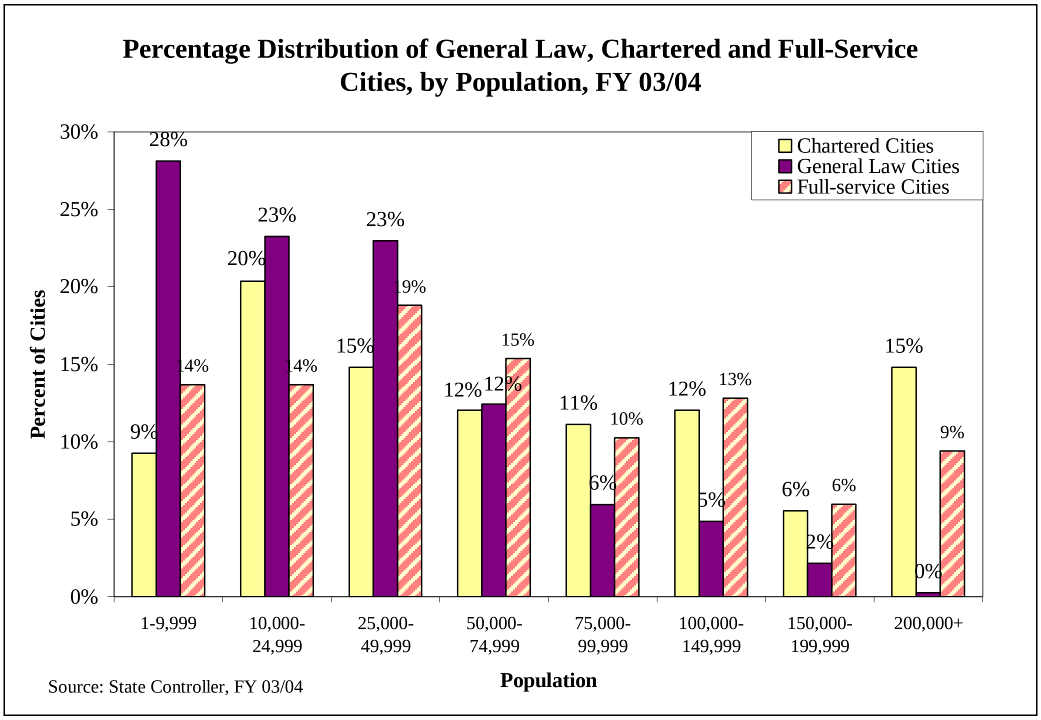
Other Interesting Facts about Piedmont's Housing Stock from Census 2000:

- In 2000, Piedmont had a median housing value of $761,400. Piedmont ranked 19th in the state. Cities and towns with higher median values than Piedmont were: Saratoga, Tiburon, Hillsborough, Los Altos, Atherton, Woodside, Portola Valley, Monte Sereno, Belvedere, Ross, Rolling Hills, Hidden Hills, Beverly Hills, Los Altos, Del Mar, Malibu, Palos Verdes Estates and Palo Alto.
- The median year built is a good summary measure of the age of an area's housing stock. For occupied housing units in the state, 1970 was the median year built. Four cities and towns in California had a median year built as early as 1939 for occupied housing units: Piedmont, San Francisco, Amador and Ross.

Population Size: Charter Cities, General Law Cities and Full-Service Cities

In FY 03/04, 44% of charter cities had populations larger than 75,000. Only 13% of general law cities were that big. The population distribution of full-service cities was similar to that of charter cities. Full-service cities provide police, fire, library, and parks and recreation services. Piedmont is classified as a full-service city and its population was 11,067 in FY 03/04.

Chart B.1



City	All Cities		Full-Service Cities	
Chartered	108	23%	53	45%
General Law	370	77%	64	55%
Total	478	100%	117	100%

Charter Cities FY 03/04:

Adelanto, Alameda, Albany, Alhambra, Anaheim, Arcadia, Bakersfield, Berkeley, Big Bear Lake, Burbank, Cerritos, Chico, Chula Vista, Compton, Culver City, Cypress, Del Mar, Desert Hot Springs, Dinuba, Downey, Eureka, Exeter, Folsom, Fortuna, Fresno, Gilroy, Glendale, Grass Valley, Hayward, Huntington Beach, Indian Wells, Industry, Inglewood, Irvine, Irwindale, Kingsburg, La Quinta, Lemoore, Lindsay, Loma Linda, Long Beach, Los Alamitos, Los Angeles, Marina, Marysville, Merced, Modesto, Monterey, Mountain View, Napa, Needles, Newport Beach, Norco, Oakland, Oroville, Pacific Grove, Palm Desert, Palm Springs, Palo Alto, Pasadena, Petaluma, Piedmont, Placentia, Pomona, Port Hueneme, Porterville, Rancho Mirage, Redondo Beach, Redwood City, Richmond, Riverside, Roseville, Sacramento, Salinas, San Bernardino, San Buenaventura, San Diego, San Francisco, San Jose, San Leandro, San Luis Obispo, San Marcos, San Mateo, San Rafael, San Ramon, Sand City, Santa Ana, Santa Barbara, Santa Clara, Santa Cruz, Santa Maria, Santa Monica, Santa Rosa, Seal Beach, Shafter, Signal Hill, Stockton, Sunnyvale, Temple City, Torrance, Truckee, Tulare, Vallejo, Vernon, Visalia, Watsonville, Whittier, Woodlake

APPENDIX C: METHODOLOGY

The property revenue analysis is based on revenue history and individual property sales records provided by the City of Piedmont. The analysis estimates what the effect of different real estate market conditions would be on Piedmont property and transfer tax revenues. The analysis is based on several assumptions:

1. There is no change in California ERAF formulas relative to 2006/07
2. Changes in property tax revenues will be in direct proportion to changes in property assessed value. Thus, if Piedmont's overall assessed value rises 4% from the previous fiscal year, the city's property tax revenue will increase by this amount.
3. Transfer tax revenues are calculated as 1.3% of the total sales value. Total value of sales is the sum of sale price for all homes sold in a given fiscal year.
4. Each home in Piedmont has the same probability of sale in any given year as any other home, despite size, location, age of home, or previous sale year.
5. Properties that do not turnover increase in value by 2% yearly, unless the current assessed value is greater than the value of the most recent sale price. This caveat would apply only if prices were declining.
6. Properties that have sold show their step-up in value (beyond the 2% annual increase) one year following the sale. This keeps the assessed value consistent with the 2006/07 base, for which the most recently sold properties have not been reassessed at the new sales value.

Some of these assumptions are short cuts based on time constraints and the volunteer nature of the analysis. While this is not a completely accurate reflection of how property taxes and transfer taxes are generated, the relationships among different factors are realistic, and the assessment model allows us to simulate how different property markets will affect assessed value and sales levels.

The assessment model lists the number of homes by the most recent year sold, average sales price per square foot, and average assessed value per square foot. Sales are generated for every year from 2007/08 through 2012/13. For each year, the number of sales and the property value appreciation (or depreciation) rate are put into the model. These can be varied to reflect strong, moderate, or weak housing markets. The model assumes properties are sold proportionately across all previous years sold.[25] For each subsequent year, the number of homes by most recent sales year is adjusted to reflect the sales in the previous year. Assessed value is adjusted for the annual 2% increase, the sales price of homes sold one year previously, and the new proportions of homes by last year of sale. The total assessed value and total value of new sales are calculated each year, and the change in these values from the previous year is also calculated. These percentage changes are then used to build revenue scenarios for Piedmont.

APPENDIX D: EXHIBITS

EXHIBIT D.1: COMPARISON OF ASSESSED VALUES

Although the median house sale price in Piedmont is over $1 million in 2007, many homes in Piedmont are still assessed under $300,000. As homes are sold, the average assessed value is increasing, however. Over the past eight years, the median assessed value almost doubled, increasing from $285,572 to $512,424.

Distribution of Assessed Value: Piedmont Single Family Parcels				
	FY 98/99		FY 06/07 January 1, 2007	
Assessed Value	**Parcels**	**%**	**Parcels**	**%**
Under $300,000	1,941	52%	1,209	32%
$300,000 – $399,999	473	12%	323	9%
$400,000 – $499,999	414	11%	314	8%
$500,000 – $749,999	576	15%	709	19%
$750,000 – $999,999	217	6%	521	14%
$1,000,000 and over	145	4%	715	19%
Total Number	3,766		3,791	
Total Value	$1,378,014,215		$2,508,742,708	
Median Value	$285,572		$512,424	
Mean Value	$365,909		$661,763	
Data Source: Alameda County Assessor.				

EXHIBIT D.2: SANITARY SEWER SUB-BASIN MAP

ENDNOTES

[i] Martin Crutsinger "Existing Home Sales Down", *San Francisco Chronicle*, Sept. 25, 2007.

[2] City of Piedmont, Council Agenda Report, *ABAG's Regional Housing Needs Allocation for the City of Piedmont*, September 4, 2007.

[3] Sports Management Group. *City of Piedmont Aquatic Study -Final Report*. September 21, 2006, Page 16.

[4] Oakland's Measure Q amended the existing library tax by both increasing the parcel tax funding for City library services and extending by 15 years the life of the parcel tax. The measure stipulated that Oakland may collect this tax only if it provides a minimum of $9,059,989 of funding for libraries each fiscal year.

[5] Committee's calculations used data from State Controller, *Cities Annual Report*, FY 2004/05. http://www.sco.ca.gov/ard/local/locrep/cities/reports/0405cities.pdf

[6] City of Piedmont, FY 07/08 Budget.

[7] Piedmont Unified School District administrative regulation 5111.1.

[8] Jeff Wieler, *Tax Stabilization and Reduction Proposals*, Submitted to the Piedmont City Council, 2005.

[9] *Appropriate Level of Unreserved Fund Balance in the General Fund (2002).* http://www.gfoa.org/downloads/budget-appropriate.pdf This policy was approved by the Executive Board of the GFOA in February 15, 2002.

[10] These surveys were obtained from Michael Coleman, CaliforniaCityFinance.com, a consultant for the California League of Cities and the California Society of Municipal Finance Officers.

[11] In some cases, survey responses were unclear as to whether the cap was binding, or just a target.

[12] Alhambra, Anaheim, Antioch, Arcadia, Beverly Hills, Burbank, Calistoga, Capitola, Carmel-by-the-Sea, Carson, Colton, Concord, Dixon, El Cajon, El Centro, Emeryville, Fillmore, Foster City, Fremont, Glendale, Glendora, Half Moon Bay, Hermosa Beach, La Habra, La Mesa, Laguna Niguel, Lincoln, Livermore, Long Beach, Lynwood, Mission Viejo, Modesto, Moreno Valley, Morro Bay, Mountain View, Murrieta, Newport Beach, Orange, Palmdale, Pismo Beach, Pleasant Hill, Richmond, Ridgecrest, Roseville, San Clemente, San Leandro, San Luis Obispo, San Ramon, Santa Barbara, Santa Clara, Santa Paula, Santa Rosa, Santee, Sebastopol, Signal Hill, Soledad, South Pasadena, Stanton, Suisan City, Sunnyvale, Thousand Oaks, Tracy, Tustin, Villa Park, Vista, West Covina, Westminster, Windsor, Yountville, Yuba

[13] There are some discrepancies between city of Piedmont records and those reported by Alameda County. According to Piedmont records, sales may have dropped as low as 125 in FY 04/05.

[14] Since 1978, some modifications have been passed limiting reassessment in cases of inheritance and allowing school related property tax measures to pass with a 55 percent majority.

[15] This occurs because the assessed value on a home sold for the first time in 20 years will certainly increase, whether the current sales price is higher than the previous year or 10% below the previous year. For example, the average price/square foot of a home sold in 1987 was $187/square foot. Appreciating at 2% per year for 20 years, this home would be assessed at a value of $278/square foot. If the home sold in FY 06/07, its expected price would be $598/square foot, 8% below the FY 05/06 price, but more than twice the value of its previous assessment. Even if the 127 households who bought homes in FY 05/06 ask for an assessment downwards of 8%, if only 25 of the homes sold in FY 06/07 were sold by homeowners who held their property for 20 years or more, then the city will not lose total assessment value. Based on the sample available for the first half of the fiscal year, this appears to be the case (14 of the 67 homes sold in the first half of FY 06/07 were previously sold before 1988).

[16] Piedmont originally was divided into 22 sub-basins, but two have since been merged.

[17] In the past three fiscal years, inflation in the San Francisco Bay area has increased by: FY 04/05 1.7%, FY 05/06 2.7%, FY 06/07 3.3%. The California Department of Finance forecast for FY 07/08 is 2.4% as of August 20, 2007. http://www.dof.ca.gov/HTML/FS_DATA/LatestEconData/documents/BBFYCPI.XLS

[18] The rate can be increased to pay for certain voter-approved bond indebtedness. Currently, the tax rate on Piedmont properties is a bit over 1.13 percent.

[19] Senate Bills No. 614 and No. 844.

[20] California League of Cities. *Fact Sheet: The ERAF Property Tax Shift*. Revised May 2007. http://www.californiacityfinance.com/ERAF_facts.pdf

[21] In the state's FY 03/04 budget, cities lost their authority to keep half of revenues collected under the local sales tax. As a result, the local sales tax rate has dropped from 1.0% to 0.5%, and the state has been reimbursing these funds to local governments through a revenue-neutral swap of property tax revenue from ERAF. The state is reimbursing ERAF by raising the state sales tax from 5.0% to 5.5%. This arrangement is referred to as the "Triple Flip." Under the Triple Flip, Piedmont receives an amount of property tax equal to the lost sales tax. Since Piedmont's sales tax revenues are so small, this did not affect Piedmont's revenue composition significantly.

[22] For readers interested in ERAF, the Legislative Analyst's Office has also published many interesting analyses. For example: *Policy Brief, Reversing the Property Tax Shifts*, April 1996. http://www.lao.ca.gov/040296_prop_tax_shifts/pb040296.pdf

[23] This discussion of Prop 1A is focused on property tax protection and summarizes information found on the CaliforniaCityFinance.com website. The text of Prop 1A can be found at: http://www.californiacityfinance.com/prop1atext.pdf More complete information on all aspects of the amendment can be found at: http://www.californiacityfinance.com/Prop1A_FAQ.pdf

[24] For additional information on local elections, see Tracy M. Gordon, *The Local Initiative in California*, Public Policy Institute of California, 2004. http://www.ppic.org/content/pubs/report/R_904TGR.pdf

[25] One might expect that this assumption could lead to an underestimate of increase in assessed value, in years when prices are rising, if it were more likely that a home that had not sold for 30 years would sell than a home that sold a year ago. Looking at historical sales patterns does not show this to be the case. In looking back at sales history, there are cases of homes reselling even within a 12 month period, while there are still a substantial number of homes that have not sold for more than 30 years. In recent years, newly sold home were more likely to have a previous sale date of less than ten years ago than a sales date of twenty or more years ago, after accounting for the existing distribution of previous sales dates.