TOWN OF CASTLE ROCK
COLORADO

MEMORANDUM

Date: May 1, 2024

To: Dave Corliss, Town Manager

From: Matt Gohl, Assistant Town Manager

Subject: Alternative Revenue Options

Discussion

Future financial planning for the Town identifies funding gaps in supporting ongoing municipal priorities including police, fire and transportation (roads). Town staff is developing options to solve this funding gap including reevaluation of existing budgeting practices. As part of this analysis, a number of alternative revenue options have been explored and are discussed further in **Attachment A** including descriptions, estimated revenue projections and other considerations pertaining to the alternatives. While there are a number of alternatives available, staff doesn't believe that these options would sufficiently address funding needs in a way that would be palatable to the community at this time.

Town staff previously explored alternative revenue options in 2021. Resulting from that initiative, Town Council asked voters to consider a new housing construction tax, lodging tax, 0.1% sales and use tax increase and a TABOR time out. Voters approved the 6% lodging tax, which is dedicated for parks and recreation purposes, and the TABOR time out which allows for excess TABOR revenue to be dedicated for police, fire and roads. The new housing construction tax would have supported police and fire purposes but was voted down (47% for/53% against). The proposed 0.1% sales and use tax increase to support open space initiatives was voted down by a wider margin, 38% for and 62% against.

The approved ballot measures have resulted in roughly $600,000 per year in lodging tax revenue supporting parks and recreation purposes and, the Town has retained nearly $24.9 in TABOR revenues since 2021 that have been used to support public safety and roads.

The Town also started collecting its allocation of the State bag fee in 2023. The Town retains $0.06 of each $0.10 fee charged for single-use bags. In total, the Town collected $197,000 in 2023, with funding to be used to provide reusable bags at Town events and to fund the Town's ongoing recycling costs at around $60,000 per year. The State-imposed fee is still assessed on paper bags, but staff anticipates a reduction in this revenue in the future because single-use plastic bags are fully prohibited as of 2024. The use of this revenue is restricted and is not available to support general municipal operations.

Attachments

Attachment A: Alternative Revenue Options

ATTACHMENT A

Alternative Revenue Options – 2024

Transportation Fee

User fees are charges that a government imposes for the purpose of defraying the cost of a particular government service. Under Colorado law, the amount of the fee must be reasonably related to the overall cost of the service. Mathematical exactitude is not required in establishing the fee. The amount of revenue generated by user fees, however, cannot exceed the overall direct and indirect costs of the services provided.

While seemingly rare in Colorado, Transportation Fees are a potential source of revenue that can be used to support specific road maintenance needs. As an example, Loveland assesses Street Maintenance Fees to support ongoing repair and maintenance needs on its roads. For 2024, Loveland charges each residential unit $3.65 per month, with higher rates for industrial, retail, commercial or institutional properties.

Current staff projections for a potential Castle Rock transportation fee are based on trip generation data. Applying this approach to a projected $8 million revenue gap for the annual Pavement Maintenance Program results in an estimated monthly fee of $10.83 per single-family home and $6.38 per multi-family unit.

Logistically, this fee could be added to each monthly water bill, with the transportation fee revenue going directly to operational needs in the Transportation Fund. This type of fee does not require voter approval and is able to be changed in the future based on land use distribution and/or forecasted maintenance expenditure needs.

Property Tax Mill Levy

The Town currently assesses a 0.920 mill levy on property owned in Castle Rock that will generate roughly $1.54 million for the General Fund in 2024 – equating to 1.9% of total General Fund revenue. Based on the 2024 Adopted Budget, property tax revenue will cover about 11 days of operations for the Police and Fire Departments. The Town Charter limits property tax revenue growth to 5.5% each year – more discussion on the growth limit is included in the following section.

Property tax is generally viewed as a stable revenue source for governmental agencies, with fluctuation based on assessed valuation of the properties within the jurisdiction. While valuation and assessment rates may vary with economic changes, the fluctuations tend to be less volatile than other revenue sources.

The Town of Castle Rock has the lowest municipal mill levy compared to other full-service Front Range municipalities. However, total property tax assessments vary widely throughout the community due to metro district assessments. Certain areas have no metro district assessments while others can be near 90 mills. Based on 2023 information, property tax payments for median homes in Castle Rock can range from roughly $3,000 to over $7,000 – the Town receives around $40 of this amount.

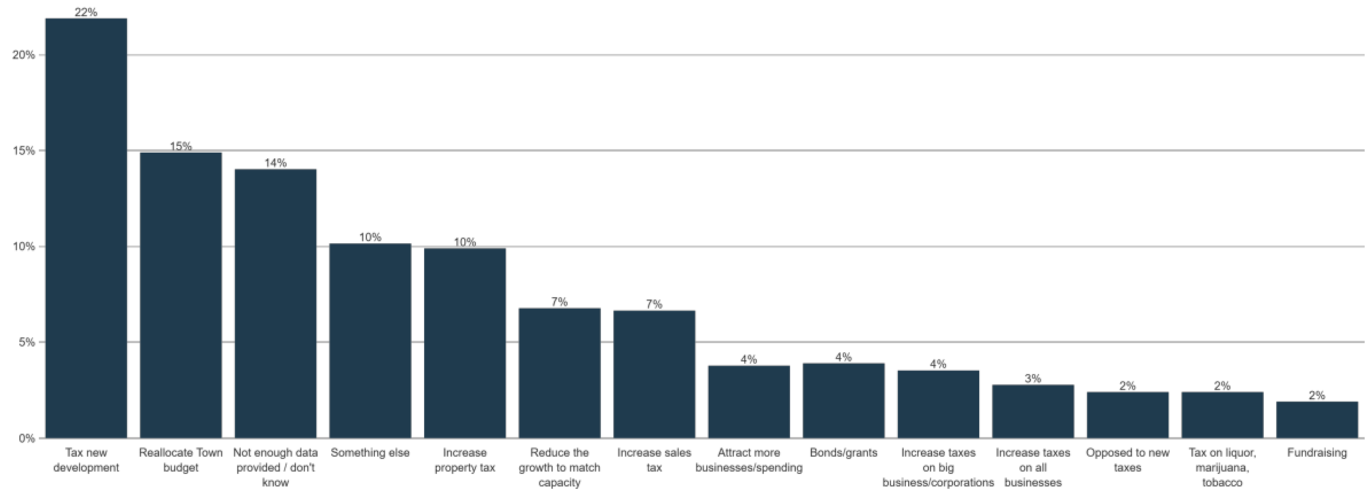
Any increase to the Town's mill levy must be presented to and approved by Castle Rock voters. Given the variation in total tax bills for Castle Rock property owners, there is likely variation in voter tolerance for increasing the Town's mill levy. Mill levy increases can be presented to voters in many ways, including asking voters to simply approve a new mill levy rate, phasing in an increased mill levy over time and/or phasing a mill levy out at a point in time.

Respondents to the Town's 2023 community survey were asked how Castle Rock should get additional revenue to fund public safety programs. The most frequent response (22%) was to tax new development, followed by reallocating the Town's budget (15%). Increasing property and sales tax responses were 10% and 7%, respectively. A chart showing all responses is below for reference.

ATTACHMENT A

Funding Public Safety Programs

When asked how Castle Rock should get additional revenue to fund public safety programs (police, fire, EMS), the most frequent response was to tax new residential and commercial development.



TOWN OF CASTLE ROCK 2023 Community Survey
Excellence · Dedication · Service

How do you propose the Town get additional revenue to fund public safety?

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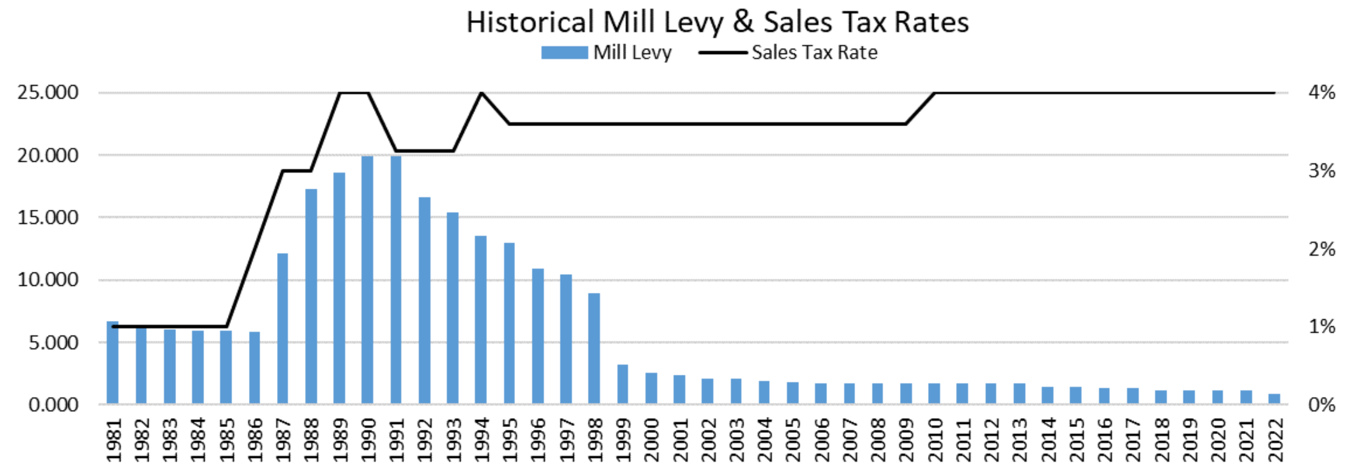
Based on the Town's 2023 assessed valuation, the value of one mill is roughly $1.68 million. Town Council could consider asking voters to approve an additional mill levy specifically to help fund public safety and/or transportation needs.

Property Tax Growth Limit Removal

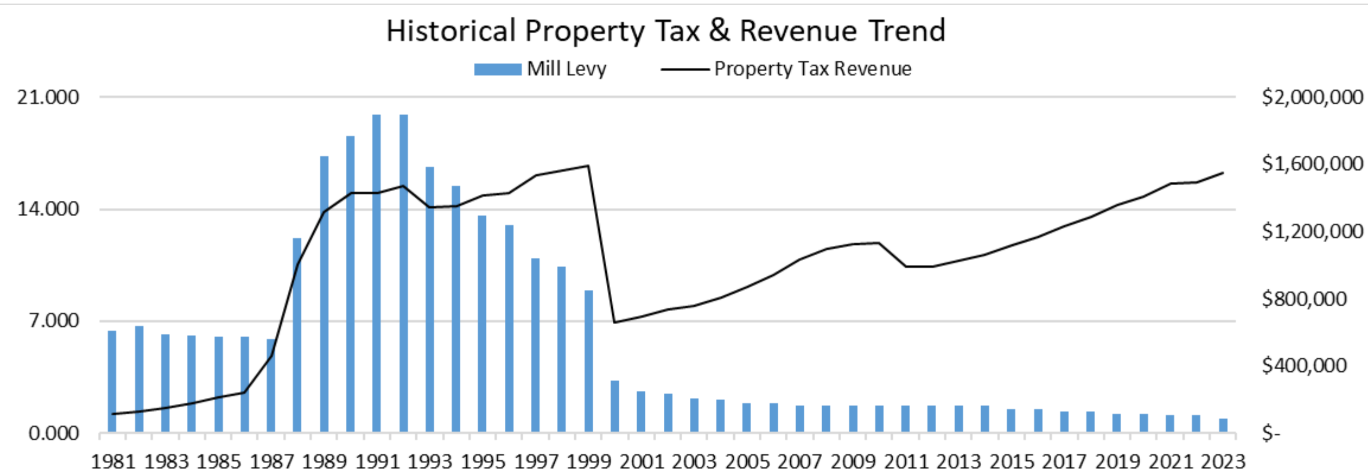
The Taxpayer Bill of Rights (TABOR) limits annual property tax revenue growth to a 5.5% increase over the previous year for statutory cities. Although this provision does not apply to home-rule municipalities, section 13-2 of the Town Charter includes the same revenue limitation on property tax revenue growth. Based on increasing valuation of Castle Rock properties, the Town's actual property tax growth has exceeded the 5.5% limit in recent appraisal years. The Douglas County Assessor's Office appraises properties and adjusts values in odd-numbered years. The 2024 assessed valuation rate for residential property equates to 6.7% of actual value and all commercial properties are assessed at 27.9%.

The Town has exceeded the 5.5% property tax growth limit in recent years. Exceeding this limit requires ratcheting down the Town's mill levy in order to remain within the 5.5% growth limit. The chart below demonstrates this impact over time and also shows the sales tax rate in each year for reference.

ATTACHMENT A



To further understand Castle Rock property tax, the following chart demonstrates historical revenue earned from the Town's mill levy. Property tax revenue is determined by applying the mill levy against assessed valuation, so revenue can increase despite a mill levy reduction. Property tax revenue growth, however, is limited to 5.5%.



Since this growth limit is included in Town Charter, removing or altering this provision requires a majority vote by Castle Rock residents. Any additional revenue received by removing this limit would be subject to TABOR revenue limits, unless exempted as part of the ballot question.

Simply removing the 5.5% limit, without any other mill levy adjustments, provides little additional property tax revenue in the near term. However, there is longer term benefit to the Town by maintaining the current mill levy assessment of 0.920 mills. This is projected to result in roughly $790,000 more property tax revenue in 2035 if the limit is removed, or a cumulative increase of $4 million between now and 2035.

<u>Sales Tax Projections</u>

The Town of Castle Rock levies a 4% sales tax on goods purchased within the community. Sales tax can be a volatile revenue source that is affected by numerous factors including recessions, business closures, inflation and more. In addition to sales tax paid by residents, Castle Rock benefits from sales tax paid by visitors and non-residents. In a 2019 study performed by Buxton Company, 92% of traffic to the Castle Rock Outlets and 58% of traffic to local grocery stores is from non-residents.

Town staff manages finances conservatively in accordance with stated priorities. As such, future revenue is projected conservatively when developing the annual budget and five-year balanced financial plan. Sales tax is planned to grow at

3% each year from 2024 – 2026, 4.5% in 2027 – 2028 and 3.5% in 2029. However, staff continually evaluates actual financial performance and updates financial plans throughout the year.

Town Council approves the annual budget and five-year balanced financial plan. By approving these, Town Council is also approving the projection parameters. While continuing to manage finances conservatively, the sales tax growth factors could be adjusted if desired. As stewards of taxpayer funds, staff believes remaining conservative is the preferred approach. Essentially, over budgeting revenues could result in necessary cutbacks, while under budgeting provides the opportunity to have funding available to invest funds in key priorities as determined by staff and Council.

Total sales tax revenue budgeted in 2024 is $75.1 million to Town funds; therefore, each 1% increase in revenue would be approximately $750,000 that would be distributed across the three benefitting funds.

Sales Tax Reallocation

The sales tax distribution was adjusted in the 2023 budget to shift 4.46% from the Transportation Fund to the General Fund. No additional changes to the sales tax allocations were made in the 2024 budget. Sales tax revenue is distributed amongst three Town funds as shown below:

Sales Tax Revenue by Operating Fund	**2024 Percent Allocation**	**Percent of Total Fund Revenue for 2024**
General	*74.75%*	*69.55%*
Transportation	*20.00%*	*46.47%*
Community Center	*5.25%*	*41.05%*

The General Fund supports key government functions including public safety, park maintenance and general government administration services such as Human Resources, Communications, Finance, Facility Maintenance, Municipal Court and the Division of Innovation and Technology (DoIT). Sales tax revenue in the Transportation Fund supports ongoing operational costs like the annual Pavement Maintenance Program and also supplements capital projects as appropriate. The Community Center Fund is largely supported by user fees but also receives a portion of sales tax revenue to support operations.

As stated in Town Code (§3.04.023), "the revenues derived from the Town's four-percent sales and use tax shall be distributed and used according to the appropriation set annually by Town Council." In practice, this annual appropriation has been affirmed through adoption of the Town's budget. Town Council has the authority to adjust the distribution of the Town's sales tax revenue among Town funds. Although voters in the past approved certain allocation amounts, there are currently no restrictions nor requirements that any specific portion of sales tax be allocated to the General Fund, Transportation Fund or Community Center Fund. Additionally, there are no existing bond covenants that require certain sales tax allocations to a specific fund – only general sales tax pledges (i.e. Transportation Revenue Bonds).

This allocation is approved by Town Council within the adoption of the annual budget. Town Council may choose to change the sales tax allocation administratively and without voter approval if desired. As noted previously, the value of each 1% change equates to roughly $750,000.

Sales Tax TIF Reallocation

A portion of sales tax generated in the Downtown area is eligible to be designated for approved Downtown uses. This portion is referred to as Tax Increment Financing (TIF) and equates to the amount of Downtown sales tax that is greater than a static base amount established in 2008. These funds are placed into the DDA TIF Fund, commonly referred to as the DDA Special Fund, and have been used to support numerous projects in the Downtown area. The DDA TIF mechanism is currently scheduled to sunset in 2038. If desired, Downtown property will have to vote to extend this time period at some point in the future.

The DDA TIF Fund has several obligations that are projected to utilize the sales and property tax revenue through 2025, including reimbursing Town funds for waived fees related to recent Downtown development projects. Although Town Council has discretion regarding the amount of sales tax TIF to allocate to the DDA Special Fund, current obligations, parking lot maintenance costs and any additional incentives for future Downtown development will limit the amount of available TIF that could be reallocated in future years.

Use Tax Reallocation

The Town assesses building use tax on construction materials when a building permit is issued. This use tax is assessed at 4% on residential and non-residential development alike. Commercial use tax is fully dedicated to the Economic Development Fund and is used to support existing economic assistance/incentive agreements and service agreements with the DDA, Downtown Merchants and Economic Development Council. Commercial use tax can vary each year depending on actual development and is budgeted to be $445,359 in 2024. Staff recommends continuing the allocation of commercial use tax to further support economic assistance/incentives for business development in Castle Rock.

Residential use tax varies based on actual development and is projected to generate roughly $3.9 million in 2024. This is based on projected 400 single-family and 330 multi-family residential units. Much of this revenue (69%) is allocated to the Transportation and Transportation Capital Funds, with another 5.61% supporting Community Center operations. The remaining 25.39% is allocated to the General Long-term Planning Fund, which is primarily used to fund replacement and repair of general government assets including technology, parking lots, building improvements and turf replacement at Town parks. A summary showing the use tax distribution by fund is shown below:

Residential Building Use Tax Revenue by Fund	**2024 Percent Allocation**	**Percent of Total Fund Revenue for 2024**
Transportation	*36.29%*	*4.97%*
Transportation Capital	*32.71%*	*10.36%*
General Long-term Planning	*25.39%*	*37.12%*
Community Center	*5.61%*	*2.13%*

While changing the 4% tax rate would require a vote of Castle Rock residents, Town Council can shift the distribution among Town funds as desired. Town Council could choose to shift the distribution among the existing four funds or designate a portion for General Fund operations as well. Based on budgeted amounts, each 1% change in allocation equates to roughly $4,500. Because building use tax is based on construction, the amount of revenue can vary significantly by year.

Tobacco Tax

The State of Colorado imposes sales and excise taxes on the purchase of cigarettes. In 2020, the State excise tax was 4.2¢ per cigarette or 84¢ per pack of 20 cigarettes. The State excise tax was increased to 11.2¢ per cigarette or $2.24 per pack – the minimum price for a pack of cigarettes is $7 (Cigarette Retailers | Department of Revenue - Taxation (colorado.gov)). The excise tax will increase again to 13.2¢ per cigarette starting in 2027. A lesser excise tax is in place for modified risk tobacco products, which are defined as having less risk of certain health effects than smoking cigarettes. A portion of the State excise tax is shared back to the municipality where the cigarettes were sold.

Statutory changes in 2019 allow local governments to assess a separate cigarette tax and still be entitled to an allocation of State cigarette tax revenue. Avon, Crested Butte, New Castle, Vail, Glenwood Springs, Carbondale, Eagle County and Summit County all have excise taxes on cigarettes totaling up to $4.00 per pack. Should Town Council wish to pursue a similar tax in Castle Rock, voter approval would be required. In 2020, Douglas County voters approved Proposition EE (increasing nicotine and vaping taxes) by a margin of 2.4 “yes” votes for every one “no” vote, indicating that Castle Rock voters may vote favorably on a tobacco tax measure.

The Town currently receives 27% of the State tax for cigarettes sold within Town boundaries. Given the Town’s recent cigarette tax revenue from the State, staff estimates that applying a 15¢ per cigarette ($3 per pack) tax could result in around $900,000 in revenue annually, not including any tax on other tobacco or nicotine products. Applying this tax rate would result in each pack of cigarettes costing at least $10 in Castle Rock. Town Council could choose to use this funding to support General Fund needs or allocate it to support other Town purposes.

If Castle Rock voters were to approve this tax, it is possible that tobacco purchasers may choose to drive to neighboring jurisdictions in order to avoid the additional cost. Additionally, tobacco tax revenue could vary based on changes in the number of users and economic factors such as disposable income.

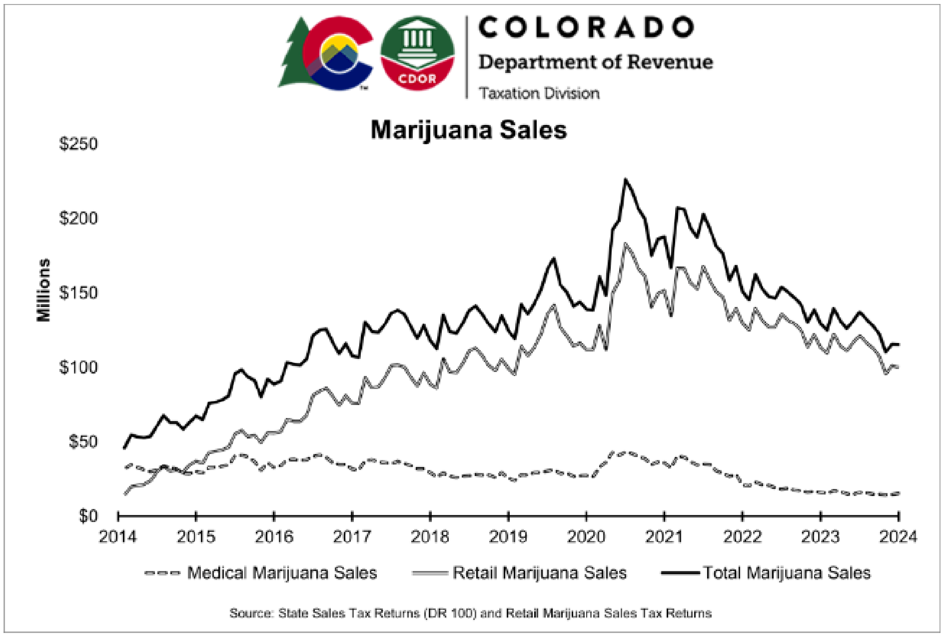
Marijuana Tax

The State of Colorado allows operation of marijuana establishments, including cultivation, manufacturing and testing facilities plus retail marijuana stores. However, the Town prohibits the operation of these facilities in the Municipal Code (§5.06.030). Medical marijuana businesses are also prohibited (§5.07.020).

Colorado voters approved the legal sale of marijuana in 2012. In addition to the State’s regular sales tax (2.9%), marijuana purchases are also assessed a 15% excise tax that is dedicated for schools, plus a 15% special sales tax. Local governments that allow marijuana sales are allocated 10% of the proceeds generated by the special sales tax.

There are many factors to be considered should Town Council wish to pursue revenue diversification through a marijuana tax. Marijuana operations and delivery into Castle Rock is currently prohibited. Any changes to these prohibitions would require amendments to the Town’s Municipal Code. Additionally, while marijuana operations generate additional revenue, staff anticipates there would be additional demands on the Town’s Police Department. These demands are not considered into Town planning and would increase the needed staffing to maintain levels of service provided by Castle Rock Police. Additional administrative staffing may also be needed to accommodate increased licensing, tax collection/audit and code enforcement needs – further limiting the benefit of the additional revenues. In addition to the marijuana prohibition on operations, marijuana facilities are also prohibited in all zoning districts. Any allowance of marijuana activity would also necessitate changes to land use in Castle Rock.

As seen in the following chart from the Colorado Department of Revenue, marijuana sales have varied widely since 2014 and are currently trending downward. Given the variability of marijuana sales, it would be difficult to maintain long-term plans supported by this revenue source.



Using 2023 information, Statewide marijuana sales averaged $260 per person per year. Applying this to Castle Rock's recent population estimate of roughly 85,000, the Town could expect to see revenue of roughly $1.2 million, including the Town's sales tax and the local government portion of the State's special sales tax. Additionally, the Town could request voters to approve an additional excise tax on the sale of marijuana in Castle Rock – each 1% of excise tax is estimated to generate $221,000 of additional revenue. Additional tax rates on marijuana sales range from 3% – 10% in Front Range communities. Staff can provide further analysis on potential revenue from allowing marijuana sales in Castle Rock if Council desires.

<u>Consumer's Use Tax</u>
The consumer's use tax is paid by consumers who purchase taxable goods in a different jurisdiction without paying sales tax but then use the goods within the taxing jurisdiction. Examples of this can include online purchases that are delivered into the jurisdiction, assuming no sales tax was paid at the time of purchase. Many online retailers now charge local sales tax rates at the time of purchase after the Supreme Court decided that businesses without a physical presence should remit sales taxes in the 2018 *South Dakota v. Wayfair* case. The consumer's use tax would apply only to transactions that were not initially taxed. Sales tax remitted to the Town by businesses located "Out of Town" and "Out of State" totaled roughly $15.7 million in 2023.

Assessment of a consumer's use tax would require approval by Castle Rock voters. This tax would also be collected locally, and additional staffing support would likely be necessary to successfully implement and administer a consumer's use tax program.

Based on regular tax audit processes, staff estimates the consumer's use tax could generate approximately $500,000 in revenue to the Town each year. Since this tax applies to goods delivered within the Town boundaries, this tax would be paid solely by Castle Rock residents.

<u>Occupational Privilege Tax (OPT)</u>
OPT, also known as a head tax, is assessed for operating a business within a specific tax jurisdiction. The tax is often paid by the employee and employer and can be applied to all businesses within a jurisdiction or applied to select types of businesses. Front Range entities with OPT include Denver, Greenwood Village, Aurora and others. The tax rate varies by jurisdiction. Current OPT rates include $2 per person per month in Aurora (paid by both employees and employers) and Denver charging employees $5.75 and employers $4 per month.

As a tax, voter approval would be required to begin assessing OPT in Castle Rock. OPT can be a predictable and potentially significant source of revenue, depending on the number of employees that work within jurisdiction boundaries. Despite the benefits of assessing OPT, it could also be a deterrent to primary employers considering locating in Castle Rock.

According to 2021 Census data, there are 23,626 jobs in Castle Rock. For every $1 (per person, per month) OPT assessed on all jobs, the Town could generate over $283,000 annually. Assuming that $1 OPT would be assessed to both employee and employer, total revenue would be $567,000 per year. Many jurisdictions have minimum income requirements, so the actual amount received could be less than estimated here.

Admissions Tax

Home-rule municipalities in Colorado are able to assess an admissions tax if approved by voters. A flat percentage would be applied to the purchase price of admission to places or events in the community that are open to the public such as movie theaters or concerts.

In accordance with TABOR, Castle Rock voters would have to approve this as a potential tax increase. An admissions tax would apply at the Douglas County Fairgrounds and Events Center, the Town's Amphitheater at Philip S. Miller Park and other Townwide events. However, because Castle Rock does not currently have large-scale entertainment venues, an admissions tax is not expected to be a significant source of revenue for the Town. Staff has estimated that an admissions tax could generate up to $100,000 per year, but actual amounts could vary depending on disposable income and the number of events held.

Local Income Tax

The State of Colorado does not permit municipalities to assess local income tax.

Real Estate Transfer Taxes

Real estate transfer taxes/fees are assessed on the sale of properties within a jurisdiction. Generally, the assessment is a percentage of the sale price. The State of Colorado does not permit implementation of a new real estate transfer tax after 1992 – the year of TABOR adoption.

Debt Issuance

Town Council could ask Castle Rock voters to consider a debt/bond issuance to fund roadway expansion projects throughout the community. Corresponding to slowing residential construction, the annual amount of impact fee revenue is less than in recent years. To pay for larger-scale projects, the Town will need to accumulate funds over multiple years, or Town Council could consider a debt issuance to proceed with projects sooner. Future year's impact fee revenue could then be utilized to pay annual debt service.

Impact Fee Evaluation

Impact fees are one-time assessments on new development that are intended to fund increased growth-related needs associated with police, fire, transportation (roads), parks and municipal government impacts. Essentially, the new growth is intended to pay, at least in part, for the impacts resulting from that new growth. These funds cannot be used to pay for operational needs, such as personnel, but can be used to fund capital needs like fire stations and roads.

The Town in 2018 completed an impact fee study to determine the maximum supportable fees for 2019. Town Council voted in 2018 to gradually increase impact fees over time to get to the maximum supportable amount, but subsequently voted to increase fees in full by January 1, 2020. Town Council also approved applying an annual inflationary adjustment to the Town's impact fees in 2018.

Staff could undertake a new impact fee study to validate previous findings and ensure that the Town is receiving appropriate impact fee amounts from new development. As a fee, these amounts can be approved by Town Council without a vote of Castle Rock residents. Additional revenues from this effort are unknown at this time and would require further research and completion of a new impact fee study.