Item # 13

Meeting Date: July 2, 2013

AGENDA MEMORANDUM

To: Honorable Mayor and Members of Town Council

From: Mark Stevens, Town Manager

Title: Discussion / Direction: Potential Tax and/or Rate and Fee Reductions

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Executive Summary

In order to be fiscally accountable to Town Council, Castle Rock taxpayers and rate and fee payers, staff is presenting some basic information regarding potential options for tax and rate and fee reductions for Council's consideration as part of the 2014 budget and 2014-2016 financial planning processes.

Should Council wish to further consider any of these options, or any other options, upon such Council direction, staff would prepare additional research and analysis for the July 30 Council financial and policy work session.

This memo outlines the options for Council's consideration and Council direction to further research and evaluate:

- Sales tax – Reducing the Town's sales tax rate, instituting a sales tax holiday or reducing the tax on food for home consumption;
- Property tax – Reducing the Town's portion of the property tax;
- Building use tax – Reducing the Town's portion of the tax paid on the value of materials in construction projects at the time of building permit issuance;
- Rates and fees – Reducing any of the various major rates and fees charged to customers for services used by those customers.

As we work through priorities for the 2014 budget, the 2014-2016 financial plan and any further updates to the Town's Strategic Plan, Council may wish to consider reducing taxes and/or fees. In that event, there will be both policy and financial implications to consider.

If financial planning shows estimated financial surpluses in any fund or area, consideration of any tax or fee reductions will need to be evaluated against potential uses of such funds. If financial planning does not show any surpluses, consideration of any tax or fee reductions will need to be evaluated against corresponding reductions in expenditures and services.

At this point, we are sharing information with the Council, responding to questions and seeking Council feedback, as to whether there is interest in further considering any of the potential tax and/or rate and fee reduction options presented, or any other such areas not specifically presented herein that may be of further interest to Council .

Discussion

Overview

In the 2013 community survey, Town residents and businesses were asked to rate their level of concern regarding six selected issues that the Town might want to address in the near future, including the reduction of Town tax rates. On a scale of 1 (being not concerned at all) and 5 (being extremely concerned), residents and businesses rated reducing Town tax rates at 3.47. The survey consultant stated in its report this means that reducing Town tax rates was not considered a major concern to survey respondents. However, while none of the areas surveyed were considered of major concern, reducing Town taxes was considered of more concern than things such as additional public transit services. A 3.47 rating on reducing Town tax rates might reasonably be interpreted as indication of some level of interest and concern, but not a top-of-mind priority issue or concern.

The 2013 community survey results also indicate some sensitivity to some rates and fees. Cost of service questions were included in some areas, with 1 (poor) and 5 (excellent), and any rating below a 3 considered an area of concern. In the Utilities area, the cost of water was the lowest-ranked service, with a rating of 2.69. In the Development Services area, cost of permits was the lowest-ranked service, with a rating of 2.71. In the Parks and Recreation area, recreation fees were the lowest-ranked service, with a rating of 3.06. So, not surprisingly, survey respondents are conscious of, and have some concern, with the rate and fee costs of some Town services.

Sales Tax Rate Reduction

The following chart shows the municipal and combined sales tax rates for municipalities in the south metro area. Comparing the combined sales tax rate in the south metro area -- generally the area in which the Town competes for sales tax-generating purchases – the Town is in the mid to high range. Looking at just the municipal rate, the Town's is the highest.

The Town is not in RTD (1.0% sales tax) or the Scientific and Cultural Facilities District (0.1% sales tax). So, even though the Town's sales tax rate is higher, the total tax rate in Castle Rock is not significantly different than other jurisdictions except for Centennial, Lone Tree, Castle Pines and unincorporated Douglas County (Highlands Ranch, for example). Since the early 1990s, Castle Rock's voter-approved tax policy has been to have a higher sales tax rate and a lower property tax rate. This takes advantage of the fact that nonresidents pay a significant portion of Town sales, whereas Castle Rock property taxes are paid entirely by Castle Rock property owners. This also reflects the fact that the Town is a full service municipality and has to use a Town tax revenue, in our case, sales tax, to pay for services such as fire, emergency medical, and parks and recreation that in many other areas are funded by property taxes though separate Special Districts. So the Castle Rock municipal services model is a higher sales tax rate and a lower property tax rate.

Sales tax rates in the south metro area

Municipality	Combined rate	Municipal rate
Aurora	8.75%	3.7500%
Castle Rock	**7.90%**	**4.0000%**
Castle Pines	6.75%	2.7500%
Centennial	6.75%	2.5000%
Denver	7.62%	3.6200%
Englewood	7.75%	3.5000%
Greenwood Village	7.25%	3.0000%
Littleton	8.00%	3.0000%
Lone Tree	6.18%	1.8125%
Parker	8.00%	3.0000%
Unincorporated Douglas County	5.00%	0.0000%
Unincorporated DC outside RTD	3.90%	0.0000%

The next chart shows what effect reducing the Town's sales tax rate would have on sales tax revenues. Staff averaged actual sales tax revenues for 2011 and 2012 across 14 broad business/industry categories. Illustrated in the subsequent columns are the revenue impacts that reductions in the Town's municipal sales tax rate could have on annual revenues in outgoing years, using those averages as the basis.

Generally, each 0.1% reduction in the municipal sales tax would decrease the Town's annual revenue by nearly $725,000. If the Town would decrease its municipal rate to 3.6%, it would realize close to $3 million less in revenue each year.

Sales tax rate reduction scenarios

Category	2011/2012 avg at 4%	3.9%	3.8%	3.7%	3.6%
Food/general merchandise	$8,635,585	$8,419,696	$8,203,806	$7,987,916	$7,772,027
Apparel/accessories	$5,405,430	$5,270,294	$5,135,158	$5,000,022	$4,864,887
Hotels/restaurants/bars	$3,359,231	$3,275,250	$3,191,269	$3,107,288	$3,023,307
Utilities	$1,818,795	$1,773,325	$1,727,856	$1,682,386	$1,636,916
Miscellaneous retail	$2,609,602	$2,544,362	$2,479,122	$2,413,882	$2,348,642
Communications	$1,277,821	$1,245,875	$1,213,929	$1,181,984	$1,150,038
Revenue enhancement	$204,463	$199,351	$194,240	$189,128	$184,017
Furniture/home décor	$558,771	$544,802	$530,833	$516,863	$502,894
Autos/auto items	$1,419,798	$1,384,303	$1,348,808	$1,313,313	$1,277,818
Home and garden	$1,980,751	$1,931,232	$1,881,713	$1,832,194	$1,782,676
Leasing and rentals	$447,227	$436,046	$424,865	$413,685	$402,504
Services	$584,755	$570,136	$555,518	$540,899	$526,280
Wholesale/manufacturing	$305,885	$298,238	$290,591	$282,944	$275,297
Agriculture/construction	$328,150	$319,947	$311,743	$303,539	$295,335
Total	*$28,936,264*	*$28,212,857*	*$27,498,451*	*$26,766,043*	*$26,042,638*
Reduction difference		**$723,407**	**$1,446,813**	**$2,170,221**	**$2,893,626**

Sales tax revenue is broken down into three funds; the allocation is as follows: 70.29% to the General Fund, 24.46% to the Transportation Fund and 5.25% to the Community Center Fund. Each of those funds, therefore, would see corresponding reductions in revenues if any sales tax reduction was implemented.

Additionally, there would be costs to inform businesses and taxpayers of the change. In 2011, the Town's sales tax rate reverted back to 4%. To implement that change, the Town's Sales Tax Division needed several additional part-time contract workers to inform each business and check each register to ensure the Town was being remitted the correct sales tax amount. Additionally, Community Relations and other staff members devoted significant resources to communicating the change.

Consideration might want to be given to temporarily reducing the sales tax rate for a specified period of time. Further research would be needed on the TABOR implications of temporarily reducing the sales tax.

Sales Tax Holiday

Another option to reduce the Town's sales tax revenue would be to implement a sales tax holiday on a specific category of purchases during a certain timeframe, for example, clothing during the back-to-school shopping period. A temporary reduction in sales tax could draw additional customers to Castle Rock businesses during this high shopping time, increasing sales. Several states have programs similar to this, and we would most likely mirror these.

Looking at 2012 numbers, instituting a seven-day sales tax holiday on clothing during August, as one example, could result in a revenue reduction to the Town of about $125,000. Designating the entire month of August as a holiday would mean approximately $575,000 less in revenues.

Additionally, there would be added communications/marketing and other costs to the Town, as there were with the 2009 "Rock Your Dollar" program. (The hard costs for Rock Your Dollar were approximately $125,000 not including employees' time spent implementing the program.) Similar to Rock Your Dollar, the benefit to the community of such a program would be: temporary tax/cost reductions; goodwill with residents and business owners; encouragement for customers in the market area to "think Castle Rock" for their shopping needs; and opportunities for business owners to enhance customer relationships and develop greater, longer-term business opportunities.

Further research would be needed on the TABOR implications of temporarily reducing the sales tax through a sales tax holiday approach.

Reduction of Sales Tax on Food for Home Consumption

Another option to reduce sales tax for residents would be to reduce the tax on food for home consumption, which in Castle Rock is taxed at the 4% municipal sales tax rate.

Currently, the Town taxes all food, whether it is for immediate or home consumption. Immediate consumption foods are those that can be consumed right after purchase, such as a single candy bar, or a prepared meal. Foods for home consumption are those bought for future use, such as a gallon of milk or loaf of bread. The taxability can be difficult to explain, but there are clearly defined standards used in this area of sales tax administration.

Most cities in Colorado tax food for home consumption including Arvada, Boulder, Brighton, Broomfield, Castle Rock, Cherry Hills Village, Edgewater, Federal Heights, Fort Collins, Golden, Greeley, Lafayette, Longmont, Louisville, Loveland, Northglenn, Parker, Thornton, Westminster and Wheat Ridge. Typically, the cities that do not tax food as such are larger and have a much broader, larger commercial base. Those include Denver, Aurora, Colorado Springs and Lakewood. However, here in Douglas County, Lone Tree and Castle Pines do not tax food for home consumption, and within Highlands Ranch, in unincorporated Douglas County, food for home consumption is not taxed.

The state's 2.9% sales tax rate does not apply to food for home consumption, nor does Douglas County's 1% rate, RTD's 1% rate or SCFD's 0.1% rate.

Staff estimates that each 1% of the Town's sales tax on food for home consumption, conservatively, generates more than $1 million in revenue annually, based on estimates of food for home consumption sales at grocery stores. Food for home consumption is also sold at convenience stores, general merchandise stores such as Walmart and Target, and at various other retail stores. Even in grocery stores, some sales are food for home consumption and other sales are general merchandise. Sales tax returns to the Town do not differentiate between food for home consumption and general merchandise sales. So it is very difficult to accurately estimate sales tax revenues solely attributable to the sale of food. Should Council wish to further consider this option, a much more rigorous effort to more accurately estimate financial impacts would needed.

Consideration might want to be given to temporarily reducing the sales tax rate on food for home consumption for a specified period of time. Further research would be needed on the TABOR implications of temporarily reducing the sales tax on food.

<u>Some Policy Considerations in Reducing Sales Tax</u>

Sales tax is sometimes considered a regressive tax, insofar as there is no relationship to ability to pay, and no direct relationship to government services received. Some argue that it is an unfair tax, in that lower-income households may spend a higher percentage of their incomes on taxable goods, and senior households may spend a lower percentage of their incomes on taxable goods. Some argue that higher-income households make higher-dollar purchases and, thus, pay more in sales taxes.

In Castle Rock, we benefit from nonresidents paying sales tax, especially due to the outlet mall and other regional draws. Castle Rock serves, to some extent, as a regional commercial hub. Also, a high percentage of the workforce in Castle Rock is nonresidents commuting to Town for work and generating sales tax while in the community working. Every dollar in sales tax revenue paid by nonresidents is a dollar that does not have to be generated by Town residents or businesses through other taxes or fees. Reducing the sales tax rate could shift more costs to Town residents and property owners.

Staff is currently working to better estimate the percentage of sales tax revenues generated by residents vs. nonresidents, but we do not have a good estimate of that at this time.

Focus is often given to the sales tax on food for home consumption, which some argue is the most regressive, insofar as families have to purchase food regardless of their household incomes. Therefore, sales tax on food can more negatively impact lower-income households. There is also some anecdotal information suggesting some residents of Castle Rock and the market area may do their food shopping outside of Castle Rock to avoid the Town's 4% sales tax on food for home consumption.

Because the Town applies its sales tax to food as well as some other areas, such as utilities, which do not tend to fluctuate significantly regardless of good or bad economic times, the Town's sales tax on food helps to provide a degree of stability in Town tax revenues. This could be considered particularly important for Castle Rock given the Town's low property tax rate. Property tax revenues are the primary revenue source used by many governmental entities to provide some stability in tax revenue streams.

It is difficult to assess what the impact on customers and taxpayers would be if the Town reduced its sales tax rate in general or, perhaps more specifically, its sales tax on food. Residents and nonresidents would pay less in sales tax but, without further rigorous analysis, we cannot yet accurately estimate what that might mean in tax reduction to an average Castle Rock household.

There is some anecdotal information suggesting that some Castle Rock residents and area residents might choose to shop in areas in the south metro area or elsewhere in Douglas County in which the sales tax rate is lower that the total 7.9% rate in Castle Rock. We do not know the extent that occurs solely for tax purposes, however, nor are we able to estimate whether a small reduction in the Town's sales tax rate would influence that customer behavior.

There is also some anecdotal information suggesting that some Castle Rock residents and area residents might choose to shop in areas in the metro area, or elsewhere in Douglas County, where food for home consumption is not taxed, or is taxed at a lower rate than the 4% rate in Castle Rock. We don't know the extent that occurs solely for tax purposes, nor are we able to estimate what amount of reduction in the Town's sales tax rate on food would influence that customer behavior.

We do know that sales tax is the Town's largest source of tax revenue. For most Castle Rock residents, it is their largest tax burden to the Town. So, a reduction in the 4% Town sales tax rate – either across the board, or just on food for home consumption – would have the most significant financial implications both to the Town and its taxpayers.

Reduction of the Town's Property Tax

Currently, the Town's property tax mill levy rate is 1.703. On a $300,000 home, the Town portion of the property tax equates to $40.67 per year. This totals approximately $1 million in annual revenue to the Town.

Each 10% reduction in the Town's property tax rate would, therefore, reduce revenues to the Town by about $100,000 per year and save the owner of a $300,000 home approximately $4 per year.

The tax savings of a property tax reduction would be greater to business property owners, given the way the property tax structure works in Colorado. For example, a typical restaurant with an assessed value of $271,600 would have property tax due to the Town of approximately $462. A newer office building with an assessed value of $397,960 would owe $677 in property tax to the Town.

All Town property tax revenues are allocated to the General Fund and thus, are primarily used to support police, fire, parks and general government services.

Consideration might want to be given to temporarily reducing the property tax rate for a specified period of time. Further research would be needed on the TABOR implications of temporarily reducing the property tax rate and levy.

Some Policy Considerations in Reducing Property Tax

The Town's property tax levy falls entirely on the owners of property in Castle Rock, so a property tax reduction provides a dollar-for-dollar tax reduction to Castle Rock property owners. Unfortunately, the value of that reduction is not that significant, due to the Town's low property tax rate.

Property tax revenues provide some stability to the Town's General Fund revenue stream. However, due to the low rate, it is a low total dollar amount and an increasingly lower percentage of General Fund annual revenues.

A percentage reduction in the property tax rate could potentially be a more manageable tax reduction from an overall Town financial perspective. It might be viewed as a more symbolic action of the Town Council cutting taxes than of real significant tax relief to the taxpayer.

Building Use Tax

Building use tax is paid on the value of materials in construction projects. It is paid at the time of building permit issuance by the entity obtaining the building permit, i.e. those building homes or commercial buildings, remodeling existing residential or commercial buildings, such as finishing basements, or completing tenant finishes. Building use tax is levied at the same rate as the municipal sales tax, 4%.

The 2013 community survey indicates some concern with the development fees. The Town's total fees are on the high side of the market, due in large part to the water and water resources system development fees required for new development to pay its fair share of water and renewable water infrastructure costs. Development fees are calculated based upon actual estimated costs and cost impacts. Building use tax is not set based upon specific allocated costs and, therefore, might be an area to consider if there is Council interest in reducing development permit fee costs.

Building use tax revenue from residential construction is allocated into four funds as follows: Transportation Fund, 36.29%; Transportation Capital Fund, 32.71%; General Long-Term Planning Fund, 25.39%; and Community Center Fund, 5.61%. These funds are used for capital projects, no building use tax revenues are used for annual operating costs.

All building use tax revenues on commercial construction are allocated to the Economic Development Fund as a source of replenishing that fund.

The Town's projected building use tax revenue for 2013 is $2,547,636. Annual building use tax revenues can be highly variable, based on the amount of new construction occurring in a given year. For example, over the past five years, building use tax revenue has fluctuated from a low in 2009 of $935,556 to a recent high in 2012 of $4,657,022.

Each 10% reduction in the 4% tax rate in 2013 would reduce Town revenue by about $255,000.

Examples of the amount of building use tax currently paid on construction projects:

- A typical single family home valued at $300,000 would be charged a Town building use tax of $6,000.
- A typical basement finish valuation of approximately 550 square feet is valued at $11,280. The Town's building use tax due on this project would be $225.60.
- A typical tenant finish is valued at $15,000. The building use tax on this project due to the Town would be $300.
- A newly built restaurant would have an approximate valuation of $321,299, with the building use tax due to the Town being $6,426.

Building use tax is currently being under assessed by approximately 25%. That is because the Town is knowingly using a 2004 valuation table to try to keep the overall cost of development fees as competitive as possible with other metro area cities. So, effectively, the Town is already providing a tax break on the building use tax.

<u>Some Policy Considerations in Reducing Building Use Tax</u>

This tax is only paid by persons obtaining building permits for new construction or remodeling. Therefore most existing residents would not see much of a financial benefit.

Reducing this tax would be more of an economic development benefit, a potential benefit to purchasers of newly constructed homes or commercial buildings, and a benefit to existing residents and businesses doing remodeling work. It would primarily be a response to concerns expressed about the cost of development fees.

Financial impacts of a building use tax reduction would fall primarily on replenishing the Economic Development Fund and funds for street maintenance, new street construction projects, and street bond annual debt service payments. To a lesser degree, impacts would be on replacement of technology infrastructure, major maintenance improvements to Town buildings and facilities, and major maintenance projects at the Recreation Center.

Reductions in Town Rates and Fees

The Town collects fees from residents and nonresidents for various services. The Strategic Plan emphasizes the importance of fees in the Town's overall financial policies and strategies.

For example, the enterprise funds of Water, Water Resources, Stormwater, Wastewater, Golf Course and Development Services are entirely supported by user fees, with no use of tax dollars. If that were not the case, either tax dollars would need to be shifted to support these functions, or levels of services provided in these areas would have to be reduced.

Fees are charged to those who actually use the services and calculated to try to recover as much of the cost of the service as is sustainable in the market. This approach reduces or eliminates the need for a Castle Rock resident or business tax toward services that the resident or business does not use.

Examples of Town rates and fees include, but are not limited to:

Rates and fees assessed to all residents:
- Water, water resource, stormwater and wastewater rates and fees

Fees for specific services used by residents and nonresidents:
- Recreation fees, including membership, daily passes, facility rental and program enrollment
- Golf fees, including green fees, cart rentals and lessons
- Ambulance fees (paid by persons receiving ambulance transport services)
- Building Permit fees

Each fee is set based on 1) cost-of-service studies and 2) service levels determined by the Town Council, staff and/or advisory boards. Not all fees assessed allow for full cost recovery for the service provided. For example, the Recreation Center is not fully funded by the fees it charges for the services it provides. Rather, the Town allocates a portion of the sales tax collected to the community center fund to offset any gap between costs and fee revenues and, in general, to make the Recreation Center facility available to the community.

The 2013 community survey indicated three areas in which there was a level of concern expressed about the cost of rates and fees: water, development permit fees and recreation fees. We did not ask questions about every Town rate or fee, and we certainly received some resident (and nonresident) concerns about golf rates and ambulance fees. It would probably be more surprising if residents and businesses indicated that they did not have concern with any given rate or fee.

Some Policy Considerations in Reducing Various Town Rates and Fees

Each potential rate and fee reduction has different policy implications.

For example, not every resident plays golf at Red Hawk Ridge, purchases a Recreation Center membership, takes recreation classes, uses the indoor or outdoor pools, obtains a building permit or receives ambulance transport to a hospital. So, if any of these fees are reduced, a portion of the cost of services used by some is shifted to a tax-funded responsibility of all, or the level of service is reduced.

If Council has an interest in further evaluating reductions in any specific rates or fees, a more detailed analysis can be performed of those specific items.

Water, water resources, stormwater and wastewater rates and fees are different, insofar as almost all Castle Rock residents and businesses use these services and pay these rates and fees. Reducing any of the Utility Enterprise rates or fees would have the broadest benefit, and this is an area of expressed concern by residents and businesses.

These Utility Enterprise rates and fees are set by cost-of-service analyses, with the intent that these services be funded entirely by user rates and fees without any general tax support. These rates and fees are also primarily established in ways that are tied to actual customer use of service. For example, the more water a customer uses, the higher the bill. The less water used, the lower the bill.

Reducing any of these utility rates and fees in response to customer concerns would require either reduction in service costs and levels of service or, use of general tax dollars to offset the rate and fee revenue reduction.

In all of these utility areas, opportunities for reducing costs are part of our day-to-day business. Any and all opportunities are continually pursued, so there are limited opportunities in that regard. Also, in this area, reductions in service of any magnitude that would significantly reduce costs, have direct public health and safety implications. So, while these areas always have some room for improvement, in reality, reducing utility rates and fees would require offsetting the reductions with the use of general tax dollars. TABOR allows up to 10% of an enterprise fund's revenues to come from nonbusiness sources, such as general tax revenues.

There are policy pros and cons of using general tax dollars to reduce monthly utility bills.

On the pro side of the ledger, this is an area of customer concern. Council is highly conscious of the affordability of monthly utility bills, and there are some particular concerns about affordability to lower income and senior residents. Virtually all Castle Rock residents and businesses would see a financial benefit every month on their bills – an immediate, highly visible and demonstrable benefit. Also, since Council has authority over these rates and fees without TABOR or voter approval issues or requirements, Council could more readily experiment with reducing these rates and fees to try things and see what may have a significant benefit and what may not.

On the con side, this would move the utility rate and fee system away from the direct relationship of how much a customer uses determines how much a customer pays, and potentially could negatively impact water conservation efforts. It would also result in the utility enterprises no longer being 100% financially self sufficient without general taxpayer support. Finally, shifting general tax dollars from the General Fund, Transportation Fund and/or Community Center Fund, depending upon the amount and the overall financial condition of the fund, could have level-of-service implications in those funds and the services those funds provide.

If Council has interest in further considering reducing all or certain utility fees, additional research and analysis can be performed.

Conclusion

The examples outlined herein show various ways Council could consider reducing taxes or rates and fees in Castle Rock. Any particular idea or option of interest to Council requires additional research and analysis. Staff is seeking identification by Council of any areas of particular interest to Council, and any direction from Council to further research and evaluate any option. Staff would then report back to Council as part of the ongoing financial priorities and policies processes for the 2014 budget and the 2014-2016 financial plan.