CITY OF GOLETA

October 15, 2020

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Gregg Hart, Chair
Santa Barbara County Board of Supervisors
105 East Anapamu Street
Santa Barbara, CA 93101

RE: REVENUE NEUTRALITY DISCUSSIONS

Dear Chair Hart:

Due to the COVID-19 pandemic, the City of Goleta is facing an unprecedented economic and public health crisis that has placed the long-term financial stability of the City at risk. It is the City's desire to work with the County to develop solutions that will ensure that Goleta is able to maintain its status as a financially stable member of the Santa Barbara County community despite these crises. However, in the face of certain and unprecedented tax revenue losses, Goleta will not be able to meet this goal of sustained financial stability if the terms of the Revenue Neutrality Agreement ("RNA") with the County remain unaltered. Failure to alter the RNA's tax sharing provisions in light of the City's anticipated tax revenue losses, will inflict permanent harm on Goleta's ability to maintain and expand its municipal services at a rate commensurate with our residents' needs and expectations, which will eventually result in a material decrease in our residents' quality of life. To avoid these outcomes, the City is submitting this letter as a formal request that, within thirty (30) days, the City and County meet to negotiate a mutual amendment of the Agreement.

The City is authorized to request these negotiations under Section 6.2.2 of the RNA, which permits the Parties to meet and negotiate regarding the possible mutual amendment of the RNA upon written notice of the occurrence of an unanticipated loss of revenue to the City under certain circumstances outside the City's jurisdictional control. However, further justifications for the Agreement's amendment, beyond those enumerated in Section 6.2.2, also exist and merit discussion at this time. As a courtesy, below, we have included a summary of the provisions of the RNA that the

City considers to be of particular concern, as well as an overview of the inequities and potential legal issues that necessitate amendment of the Agreement. This overview is meant to be non-exhaustive and is provided solely for the purpose of facilitating productive discussions as quickly and efficiently as possible. Nothing in this letter should be taken as an indication that the City concedes its satisfaction with any terms of the Agreement as currently written.

A. <u>Under Section 6.2.2 the parties are required to meet and negotiate regarding necessary amendment of the RNA</u>

At Section 6.0, the RNA enumerates a non-exhaustive list of circumstances, under which the Parties are required to meet and negotiate regarding the possible mutual amendment of the RNA. One such circumstance involves the City's unanticipated loss of revenue. This provision specifically requires that the Parties meet to negotiate in good faith within thirty (30) days of receipt of written notice of the following:

> "Unanticipated loss of revenue to the City by circumstances outside the City's jurisdictional control, other than statute or legislative or executive order, that materially alters the City's anticipated revenue or materially increases services costs over those anticipated in this Agreement or in the CFA."

The Country is facing an unprecedented economic recession. In this rapidly worsening economic climate, local jurisdictions are poised to suffer significant financial damage due to lost tax revenues. The City has already seen a net decline in sales tax cash receipts of $0.25 million. However, the decline in sales tax cash receipts from specific industry groups including, autos and transportation, building and construction, business and industry, fuel and service stations and restaurants and hotels has, thus far, totaled approximately $0.57 million. In the near future, the City anticipates that these revenue losses will only continue to climb.

Furthermore, between March and June of this year, the City also saw a dramatic decrease in transient occupancy tax revenues of $2.9 million in comparison to the same period in the year prior. Due to the fact that the City shares a significant percentage of the City's property and sales tax revenues with the County, Goleta is forced to rely on transient occupancy taxes for its primary source of general fund revenues. However, transient occupancy taxes are a particularly volatile revenue source, and the COVID-19 pandemic has exacerbated this volatility. On an annualized basis, the City experienced a $2.5 million loss in transient occupancy tax revenues, which represents approximately twenty five percent (25%) of the City's $10 million average annual transient occupancy tax revenues over the last three years. These losses are all the more staggering when viewed in light of the fact that, over the course of last fiscal year, the City experienced a full fiscal year of two new hotels operating and rebranding of the already lucrative Bacara Resort as a Ritz Carlton property. Given the significant impacts that COVID-19 has had on the tourism and travel industry, the City's transient occupancy tax revenues are expected to remain severely impacted. As explained in more detail below, while these lost tax revenues will be disruptive for every city in the County, Goleta finds itself in a particularly precarious position due to the onerous terms of the RNA. As a result, the unanticipated loss of tax revenues due to COVID-19 will only further materially alter the City's already handicapped ability to provide necessary municipal services to its residents.

This additional strain on the City's anticipated revenue streams could not come at a more inopportune moment. Along with the rest of the Country, the City is facing a deadly global pandemic that will continue to require the ongoing provision of increased municipal resources and services to ensure the health and protection of City residents. Current projections estimate that the City will require $1.3. million in excess revenues through June 2021 in order to respond effectively to the COVID-19 health crisis. If the City is forced to continue relying on vulnerable transient occupancy tax revenues as the main source for the City's general fund revenues, the City will simply be unable to meet the demands of the COVID-19 crisis. Due to these grave circumstances and for the additional reasons enumerated below, the City respectfully requests a meeting with the County, pursuant to the provisions of Section 6.2.2, to renegotiate the terms of the RNA.

B. <u>The tax sharing terms of the RNA are inequitable and require revision</u>

The pre-incorporation proponents and the County negotiated, among other terms, two categories of tax sharing provisions: (1) mitigation allocations intended to mitigate the County's loss of excess revenues generated by the unincorporated area that would become the City of Goleta; and (2) ongoing service allocations intended to cover the County's costs of providing ongoing services to the newly incorporated City. Under the current terms of the Agreement, the second category of payments are permanent and are structured as follows:

> "4.2.1 After incorporation of the City, the County will continue to have ongoing obligations to provide public services to the City and its residents, and that such services are reasonably estimated to amount to $3,300,000 during the first complete fiscal year following incorporation. In order to ensure that the effect of incorporation is neutral as to the County, the parties agree to the following allocations of tax revenues in perpetuity:
>
> > (i) Property tax generated by property located within the City and which would otherwise accrue entirely to the City, commencing on the Effective Date will be shared equally by the parties;
> > (ii) 30% of the 1% retail sales tax revenues allocable to the City shall be allocated to the County."

As stated in Section 4.2.1, the cost to the County of providing ongoing services in the first fiscal year following the City's incorporation was estimated to be $3.3 million. However, as the County is undoubtedly aware, the revenues that the County currently receives under the terms of Section 4.2.1 have since steadily increased far more than $3.3 million due to consistent growth of the City's tax base. This steady increase in the City's ongoing service allocations is driven by the percentage based formula for calculating the allocations which is problematic because (1) this percentage based formula directly contradicts state issued guidelines regarding the development and calculation of revenue neutrality allocations, an issue discussed in more detail below, and (2) this arrangement allows the County to continue receiving excess revenues generated within Goleta that may be used to provide services to residents in other cities and unincorporated areas.

The City estimates that, since the City's incorporation in February 2002, the County has been receiving on average $29.8 million annually in property and sales tax revenues generated within Goleta. Approximately one third of the property taxes that the County currently receives from the City are attributable to the County's share of Goleta's property taxes under Section 4.2.1(i) of the RNA. The County's remaining share of property taxes generated within Goleta is mandated by statute. Similarly, the County receives a 31.9% statutory allocation of sales taxes generated within the City in addition to the County's RNA sales tax allocation, to which the County is entitled under Section 4.2.1(ii). This raises the County's total sales tax allocation to 36.03%. Statutorily mandated property and sales tax allocations are shared with the County by every other city in the County, but Goleta is the only City that shares a portion of its property and sales tax revenues under both the statutorily mandated allocations and under the terms of the RNA.

This inequitable arrangement cannot continue. The Parties included provision for the amendment of the RNA for a reason—they anticipated that, over time, it may become clear that the terms no longer serve to achieve the Agreement's stated purpose. This frustration of purpose has come to pass, and the City has acted in good faith for some time now in trying to secure the County's cooperation to rectify this issue and to honor the terms and purpose of the original Agreement. The County's continued refusal to amend these terms has harmed the City and is a contravention of current state policy regarding revenue neutrality requirements.

C. <u>Due to the inequitable tax sharing provisions of the Agreement, the City has been forced to forego providing necessary municipal services</u>

The inequitable terms of the Revenue Neutrality Agreement have dramatically hindered the City's ability to grow and develop in a fiscally stable manner. Because the County continues to collect excessive revenues under the terms of the RNA, Goleta has been forced to simply forego providing its residents with certain necessary municipal services altogether. And although this arrangement has always been both unconscionable and unsustainable, the current global economic and health crises render the situation dire. In the face of certain and dramatic revenue shortfalls coupled with an increased need for municipal services, the City simply cannot afford to continue sharing revenues with the County at a rate in excess of the amount intended by the parties.

The City estimates that, through June 30, 2020, the County has received approximately $122 million in revenues under the terms of the RNA, and that, if nothing is done to alter the terms of the Agreement, in thirty (30) years the County will have received nearly $375 million in revenues under the Agreement's terms. It is all but certain, that the impact of the City's incorporation on the County is not now nor ever will be equal to the nearly half a billion dollars it is trending towards. The harm done by this gross inequity extends well beyond the damage done to the purpose of the Agreement. By continuing to require the City to relinquish revenues, the County has forced the City to forego providing social welfare programs, affordable housing, assistance for seniors, childcare services, recreational services programs, properly managed and improved public facilities and park and open space maintenance, adequate library services, and improved sidewalks and roads built to handle the City's current traffic volumes, to name just a few of the many necessary municipal services that City is unable to provide or maintain. If allowed to continue, it is likely that the City's inability to maintain municipal service levels at a rate commensurate with the City's growth will eventually hinder the City's efforts to properly maintain infrastructure. The City's continued deferral of necessary infrastructure maintenance will increase public safety risks, placing the lives and well-being of residents at jeopardy.

Furthermore, as noted above, the City anticipates that it will need at least $1.3 million in excess revenues through June 2021 to adequately respond to the COVID-19 crisis. However, in part because the terms of the RNA have forced the City to rely on rapidly dwindling transient occupancy taxes as a primary source for general fund revenues and because the City is already sharing revenues under the terms of the RNA far in excess of the amount originally contemplated by the Parties, the City is in position to fall short of the revenues required to meet the COVID-19 crisis.

These negative outcomes—not to mention the continued inequity and inherent unfairness of the RNA itself—may be avoided by the immediate amendment of the Agreement's ongoing tax sharing provisions. Additionally, amending the RNA's ongoing tax sharing provisions affords the Parties the opportunity to bring the Agreement back into compliance with public policies regarding revenue neutrality and back onto equal footing with other revenue neutrality agreements throughout the State.

D. <u>The RNA's terms are unprecedented and contrary to public policy</u>

No other revenue neutrality agreement in the State resembles the agreement between Goleta and the County. First and foremost, the agreement is the only RNA in the State that requires revenue sharing with the county in perpetuity. Furthermore, previously conducted comparative assessments have indicated that, on average, Goleta shares 28% more in General Fund revenues with the County than any other city in the State. Besides showcasing the gross unfairness of the agreement, the unprecedented nature of these terms is also indicative of the Agreement's inconsistency with current public policy.

The Goleta RNA was adopted by the newly formed Goleta City Council in February of 2002. Little more than a year later, the California Office of Planning and Research ("OPR") issued guidelines for the LAFCO Incorporation Process that addressed the statutory revenue neutrality requirements. These guidelines stated explicitly that revenue neutrality agreements should be negotiated pursuant to the following policy: "Only identifiable and recurring revenues and expenditures should be evaluated for purposes of determining revenue neutrality. Generally, anticipated or projected revenue growth should not be included."[1]

By tying Goleta's ongoing revenue sharing allocations to a percentage rather than a fixed rate of the City's property and sales tax revenues, the agreement included, and the County has subsequently dramatically benefitted from Goleta's projected and actual revenue growth. As a result, the County has received and is continuing to receive a revenue windfall far above and beyond what was or is necessary to mitigate the impact of incorporation on the County. This continued inequity would simply not exist if the RNA's terms were consistent with OPR policy against factoring projected revenue growth into the determination and negotiation of revenue neutrality.

Compounding this issue is the fact that the Agreement has, thus far, failed to meet OPR's guidelines regarding the necessity for a means of adjusting ongoing payments. Specifically, the OPR guidelines state that "revenue neutrality agreements that provide for ongoing payments may provide for the permanent sharing of revenues…*if a means of adjustment after incorporation is included*."[2] The current Agreement has proven itself to contain no such means of adjustment. The terms contained in Section 6.0 have, thus far, been woefully inadequate for any purpose related to an adjustment of the ongoing payments as evidenced by the fact that the City has attempted to engage in good faith negotiations with the County on multiple occasions, and, in each instance, has been met with a refusal on the County's part to seriously entertain amendment of the ongoing service allocations.

Furthermore, the County now enjoys access to new revenue source opportunities such as those presented by the Cannabis industry that did not exist at the time the RNA was signed. In light of these changed circumstances, the County's unwillingness, to date, to work with the City to amend the Revenue Neutrality Agreement such that it is not only fair and equitable, but, at a bare minimum, also compliant with OPR policies is no longer sustainable. During the forthcoming negotiations, the City seeks the County's earnest cooperation in developing an amendment to the Agreement that ensures the City's sharing of revenue with the County will not be tied to the City's projected revenue growth in perpetuity, and that incorporates an efficient means of adjusting any future sharing of revenue when doing so is necessary to ensure that the City's incorporation remains revenue neutral for both Parties.

E. <u>Amendment Options</u>

It is the City's desire to come to an agreement that is equitable and fair to both Parties. We recognize that the County faces its own financial challenges and that the County currently relies on revenues shared under the terms of the RNA. Moving forward, however, the continued perpetuation of a fundamentally unfair contract that deprives Goleta residents of tax revenues, to which they are rightfully entitled, is not an acceptable

[1] OPR Incorporation Guidelines p. 43
[2] OPR Incorporation Guidelines, p. 47.

solution. To that end, we respectfully propose a gradual phasing out the revenue sharing in equal reductions over a period of time that is acceptable to both Parties. We are confident that this proposal will allow the County ample opportunity to mitigate the loss of excess revenues currently generated under the terms of the RNA, while also ensuring an eventual end to the loss of tax revenues rightfully belonging to Goleta's residents.

In anticipation of these negotiations, the City also respectfully requests that the County prepare and provide the following documents to the City prior to the Parties' initial meeting:

- County Budgets and Annual Financial Reports for Fiscal Years 2001-02 through the present;

- Total County expenditures delineated by districts and/or area codes for Fiscal Years 2001-02 through the present;

- Total property tax and sales tax revenues generated in Goleta's city limits and amounts allocated to each entity for Fiscal Years 2001-02 through the present; and

- County services supported by the General Fund cost per capita breakdown.

The RNA requires an initial meeting of the Parties within thirty (30) days of receipt of this notice. The City has appointed a two-member Council Committee to negotiate on its behalf, and we will be in touch with County Chief Executive Officer, Mona Miyasato, to schedule the initial meeting prior to November 14, 2020. We expect to discuss a broad range of options for revising the Agreement. However, as outlined above, the City's paramount concern is and shall remain the adoption of an amendment that eventually concludes the City's obligation to share its tax revenues in perpetuity.

Sincerely,

Paula Perotte

Paula Perotte
Mayor

CC: Supervisor Das Williams
Supervisor Joan Hartmann
Supervisor Peter Adam
Supervisor Steve Lavagnino
Chief Executive Officer Mona Miyasato
State Senator Hannah-Beth Jackson
Assemblymember Monique Limón
Councilmember Kyle Richards
Councilmember Roger S. Aceves
Councilmember Stuart Kasdin
Councilmember James Kyriaco