CITY OF BOULDER

BLUE RIBBON COMMISSION ON REVENUE STABILIZATION

Report to City Council
January 15, 2008

City of Boulder
Blue Ribbon Commission on Revenue Stabilization

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BLUE RIBBON COMMISSION (BRC) ON REVENUE STABILIZATION

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Introduction

A central theme of the 2006 City Council retreat was financial issues associated with five years of declining revenue and service levels. Consequently, the City Council articulated an initiative for revenue stabilization and subsequently commissioned a Blue Ribbon Commission with the following purpose:

> **Establish a long-term, balanced and stable revenue stream for the city of Boulder that accomplishes public priorities, while allowing flexibility to meet the varied and dynamic needs of the municipal corporation in the next 20 years.**

This commission of community leaders and public finance experts convened regularly from July 2006 – December 2007 to accomplish this mission.

As the purpose statement notes, the commission was tasked with looking at a 20 year planning period. For consistency, the commission used the year 2030 as its planning horizon because it corresponded with the planning time frame of the Boulder Valley Comprehensive Plan.

The work of the commission proved extremely challenging and took the group in directions not anticipated at its commencement. Along the way, there were many research projects, presentations and much brainstorming. The result was the creation of a substantial body of analytical material that shaped the final recommendations. Consequently, this final report is broken into an executive summary, four chapters and a host of appendices.

The commission wishes to thank the 2006 City Council for its confidence and for giving it the freedom to tackle this challenging issue that is sure to resonant throughout the state of Colorado.

Executive Summary

The Blue Ribbon Commission (BRC) projected revenue and expenditures for nine City of Boulder funds from 2006 through 2030 as a starting point for its revenue stabilization endeavor. The scope of this analysis did not include every city fund. Although most city programs and services are reflected in the analysis, a few high profile programs were not included due to the time constraints associated with development of detailed projections for smaller funding sources and the inherent difficulty of projecting external funding sources (see Appendix J for more detail). This modeling exercise revealed that Boulder's revenue would grow approximately three percent a year over the planning horizon while expenditures are anticipated to grow at approximately four percent per year. This one percent difference each year projected over 24 years results in a $90 million shortfall in the expanded General Fund in the year 2030 assuming all expanded General Fund sales taxes are renewed through the period. The expanded General Fund provides funding for services and programs typically considered basic city services.[1]

The principle reasons for the growth differential is the decreasing productivity of sales tax revenue and the above average inflation rate of government inputs. Specifically, the BRC found that sales tax productivity will continue to decrease due to a flat inflation rate associated with durable goods, durable goods diminishing as a percentage of personal consumption, changing demographics leading to fewer purchases of sales tax eligible products, and continuing increases in e-commerce. Conversely, the cost of municipal inputs will outpace revenue growth due to inflation rates associated with energy (to operate offices, recreation centers, libraries and fleets), building materials (oil for streets, cement for sidewalks), and personnel (salaries, pensions, health care). These diverging trend lines create an ever expanding *gap*.

This *gap* is compounded by the fact that 41% of Boulder's expanded General Fund sales tax rate is set to expire during this same planning horizon. Factoring this into the model expanded the *gap* for the General Fund to $135 million a year in 2030 (in 2030 dollars). This means, it will cost $135 million more than Boulder's revenue system will generate to provide the same bundle of services at the same service standard in 2030 as it did in 2006. Even if these expiring sales taxes are continued, the gap in 2030 will be $90 million. Furthermore, simply increasing sales tax rates, as has traditionally been the revenue tool relied upon by municipalities in years past, can only solve the problem in the short term, and continue over-reliance on a volatile revenue source.

Therefore, the BRC has recommended a three-prong approach to stabilizing revenues and obtaining funding for implementing portions of Council-adopted Master Plans, creating a solution framework comprising policies, revenue structure changes and increased revenue amounts. The BRC identified thirty policies to improve Boulder's fiscal climate towards

[1] In Boulder, due to earmarked revenues, the General Fund does not support all of these services. Thus, for this study, the concept of the expanded General Fund is used to capture General Fund expenditures, plus all or some expenditures by the Library, HHS, Environmental Affairs, Arts, Parks and Recreation, Transportation, and P&DS. See Appendix J for more detail.

a more stable, efficient, flexible and strategic environment. Boulder should also make meaningful changes to its revenue structure such that it decreases dependence upon sales taxes and shifts towards revenue streams that are more stable and are more likely to grow at a pace equal to expenditure inflation. Those revenue tools most likely to achieve these criteria without further legislative changes on the state or national level are property taxes, fees and sales taxes on services. Specifically, the BRC calls for the full de-Brucing of the Boulder property tax, an increase in the development excise tax to a level at least competitive with surrounding municipalities and ideally set at a rate that fully recovers costs, and the exploration of a sales tax on selected services. Unfortunately, these changes will not eliminate the *gap* entirely and increasing the total amount of revenue generated must also be accomplished.

The BRC has identified the renewal of existing sales taxes as the top priority for revenue stabilization in Boulder. There are six sales taxes set to expire during this planning horizon that account for 41% of the city's sales tax rate. Combined, this would be a loss of $36 million dollars a year in 2008 dollars; to put this amount in perspective, this equates to more than the entire Fire, Housing and Human Services and Library budgets combined. Of most pressing concern is the expiration of the 0.38% General Fund sales tax in 2011 and a second General Fund sales tax in the amount of 0.15% in 2012. The General Fund pays for core services such as public safety and administration, but also provides very significant transfers to Parks & Recreation, Library, Housing & Human Services, Code Enforcement, and more. Renewing these sales taxes is critical.

Three sample alternative funding packages that take into consideration the size of the *gap* in different years, the tax burden upon different constituencies, and the revenue diversification necessary for stabilization have been provided as examples of how the gap could be addressed. Unfortunately, the BRC was unable to provide city council with a recommendation that cures these financial difficulties through 2030. The political, legal, and financial variables are so significant over a 24 year period that it is unwise to lock-in a complete solution now. Therefore, the BRC has provided a set of options that will provide financial stability through the year 2017 and will set the stage for ongoing financial planning.

It is hoped that this document will serve as the inaugural Comprehensive Financial Plan for the City of Boulder. This document would be similar to, and perhaps eventually part of, the Boulder Valley Comprehensive Plan. A comprehensive financial plan looks at the fiscal big picture for this municipal corporation, is reviewed annually to reflect changing economic and budgetary conditions, and provides multiple tools to guide the community in sustaining its unique quality of life.

In addition, we recommend a comprehensive update be completed every five years to determine if the gap has increased, decreased or is consistent with original projections and assumptions.

A full reading of this report will unveil the very challenging financial future we face. Tackling this challenge will require extensive public education and debate. The members of the Blue Ribbon Commission stand willing to participate in both of those tasks and thank the 2006 City Council for the opportunity to participate in this important work.

1 The Problem

Boulder's revenue instability, beyond that associated with the erratic business cycle of a free market economy, is a product of Colorado's public finance structure and policy choices made by the city. Specifically, any free market economy will suffer the peaks and valleys of economic expansion and contraction. A government organization can expect to see corresponding variations in its revenue stream; however, the scope and depth of theses variations is impacted by the public finance mechanisms it uses and policy choices it has made.

Moreover, revenue instability leads to service provision instability, which is the real impact on the community. In order to stabilize the provision of services, we need to understand the relationship between revenues and expenditures through the projected timeframe of the year 2030. Our findings show a significant deficit (a gap) in the year 2030 due to demographic changes and incongruent revenue/expenditure trends. This gap is exacerbated by expiring sales taxes. The ability to additionally incorporate master plans that speak to growth and service enhancements thus becomes an even more daunting problem. That being acknowledged, the Blue Ribbon Commission (BRC) respected its charge and attempted to resolve the projected gap and the provision of new and enhanced services through less volatile revenue sources

<u>COLORADO'S PUBLIC FINANCE STRUCTURE</u>

There are three principal forms of taxation in public finance—income tax, property tax and sales tax. Correspondingly, different levels of government in Colorado are dependent upon one of these sources. The state primarily relies on income tax (although it generates significant revenue from a state sales tax), county and school districts rely on property tax (although counties are eligible to impose sales tax for certain limited services such as open space), and cities are reliant on sales tax (although they do generate a meaningful revenue stream from property taxes). Only the state can impose a pure income tax. Cities can however impose a tax known as a head tax or occupational privilege tax. In Colorado, Aurora, Denver, Greenwood Village, Sheridan and Glendale have implemented a head tax**.**

This separation of revenue streams among divisions of government assists in spreading the tax burden among different types of taxpayers thus addressing equity, benefit and ability to pay issues. For individual government entities however, this reliance on one form of public finance creates revenue instability. *<u>For municipal corporations, the reliance upon sales tax has a number of de-stabilizing repercussions</u>.* Sales and use taxes are the principal revenue source for the city of Boulder (comprising 47 percent of the General Fund, 39% of the overall city budget, and 44% of the Expanded General Fund). Property taxes are another major revenue source and provide 19% of the revenues in the General Fund, 10% of the overall city budget, and 12% of the Expanded General Fund.

The BRC focused on the city's funds that provide basic governmental services (excluding water utility funds), including Police, Fire, Administrative Services, Parks and Recreation and the Library. For the purpose of this study, these funds have been combined and are referred to as the "Expanded General Fund". See Appendix J for additional information on the Expanded General Fund.

Sales Tax

Sales tax, and its companion the use tax, are assessed on tangible goods. For example, refrigerators, cars and building materials are subject to sales or use tax. Boulder has a 2008 sales tax rate of 3.41 percent. This combines with the state sales tax rate of 2.9 percent, an RTD, Invesco Field at Mile High and SCFD sales tax rate of 1.2 percent and a county sales tax rate of 0.65 percent for a total sales tax rate of 8.16 percent (see Appendix A for a comparison of municipal sales tax rates). The impact of this revenue source, and the municipalities' dependence upon it, is that each municipality can grow its revenue by growing the vendors who sell sales tax eligible goods. This in turn may lead to land use decisions that create unintended consequences such as traffic congestion, pollution or parking challenges. Of even further consequence, municipalities become very competitive with one another for the large sales tax producers. This competition has resulted in municipalities granting tax concessions or rebates that diminish the net revenue gain of the development for the community. Because there is no system of revenue sharing with sales tax on a state or regional level, this competition will continue at a fierce clip specifically between Boulder, east Boulder municipalities and the city and county of Broomfield.

Additionally, sales and use tax is a very volatile revenue source. The goods that are eligible for sales taxation are often discretionary products. When economic times are tight, consumers will more likely forego a new mp3 player, skis or night out on the town. Likewise, in tough economic times, there is less new construction and acquisition of business personal property, the lifeblood of the use tax. Boulder, like many Colorado municipalities, has not seen as much of a dip in use tax revenue since lower interest rates in the early part of the decade have facilitated some construction and invigorated the new car market. Unfortunately, interest rates are also volatile and this situation can be expected to change. Moreover, many of the items that are subject to sales tax are now being purchased over the Internet—a vending location that is not required to pay sales tax. This erodes the revenue generating power of this public finance mechanism for municipalities even though cities are still required to provide programs and services to those making the purchases over the Internet.

A distinct advantage of the sales and use tax is that a small change in the tax rate can generate significant revenue. In 2008, one tenth of one percent sales tax rate is expected to generate $2.5 million per year. The sales tax sounds and is very small when thinking that a penny tax on a $10 purchase will generate over $2 million for the city. This makes the sales tax a more palatable revenue source. Additionally, it is a tax that puts more power in the consumer's hands because in large part they control the purchases they make and the location of those purchases. Lastly, since 50,000 workers commute into Boulder daily, non-residents significantly contribute to sales tax revenues. For these reasons, municipalities (Boulder included) look to the sales tax to fund both general and specific programs and services. Sales tax is and will continue to be the workhorse of the city's revenue stream.

Property Tax

Property taxes are generally considered to be a more stable form of revenue than sales tax. However, there are structural issues with property taxes in Colorado that lead to revenue instability. These are the Gallagher and TABOR constitutional amendments - Gallagher (named after the amendment sponsor Dennis Gallagher) and TABOR (Taxpayers Bill Of Rights). Both of these amendments have a significant impact on the city of Boulder's property tax.

Gallagher

Property tax revenue is generated by a mill levy multiplied against the assessed valuation. The Gallagher Amendment prohibits residential property owners from paying more than 45 percent of the total amount of property taxes in the state of Colorado. To accomplish this, one must understand how property tax revenue is generated. Every property has an "actual" value. This is more often known as its market value. How much is your house worth? For businesses, it is the value of the land, building and equipment. Most communities have far more houses than they have businesses. If one added up the actual value of all the residences and compared it to the actual value for the business properties, they would find significantly greater value in the residential stock than the commercial stock. For Boulder, approximately 80 percent of the actual value is in residential and 20 percent is in business.

Rather than have two different property tax rates to accomplish the 45/55 split, the actual value is translated into an "assessed" value and the same property tax (mill levy) is applied to all properties (the state adjusts the assessment rate every other year to meet the Gallagher requirement). Looking at the state as a whole, the actual value of residential property is multiplied by 7.96 percent to arrive at the assessed value. Business property is assessed at 29 percent. For 2007 property taxes, when these rates are applied to the actual value in Boulder, commercial land owners pay 53 percent of the total property tax bill and residential property owners pay only 47 percent. In other words, residential property makes up 80 percent of the actual value of property in Boulder, but only pays 47 percent of the property tax. Another way of looking at this situation is that $100,000 in actual value for a commercial property generates more than three times the property tax revenue compared to a $100,000 residential property.

So from a city perspective, trying to either provide the greatest menu of services or establish the smallest possible burden upon its voters, the public finance system in Colorado is geared towards growing businesses and minimizing residential growth. If those businesses also generate sales tax, either through retail sales or many employees who buy taxable goods, it becomes even more desirable. For Boulder, this is one aspect of the often debated "jobs/pops" debate. Boulder is very unusual among Colorado municipalities in that it has as many jobs as it does residents. The impact of this phenomenon will be discussed under the Policy Decisions subsection below.

Taxpayers Bill of Rights (TABOR)

The Taxpayers Bill of Rights (better known as TABOR), was adopted statewide in 1992. It was largely characterized as "no increase in taxes without a vote." Such a concept was and is very popular. Unfortunately, there was more to this amendment. TABOR sets a cap on the amount of revenue a municipality can receive regardless of its tax rate structure. This means that if the sales tax and property tax rates stay absolutely constant from one year to the next, but the businesses that generate sales tax and the value of property grows faster than the Consumer Price Index (CPI) plus population growth, that additional revenue must be returned (to whom is another matter that was not specified in the amendment and will not be discussed here). Municipalities may keep this revenue above the cap, but only through a vote of the residents. One strategy employed by many Colorado municipalities is to vote to lift the revenue cap. The process is known as "de-Brucing" after Douglas Bruce, an author of TABOR.

Boulder has de-Bruced all of its sales tax, but only the 2.0 mills of its property tax dedicated to public safety services. De-Brucing the rest of its property tax would generate approximately $6.7 million annually in 2008 dollars for general city, library, affordable housing and park services. Therefore, it will be discussed at some length in the solutions part of this document.

The link between TABOR and revenue instability can be found during the recovery from a recession. Again, a revenue cap is established each year based upon the revenues received from the prior year. During a recession, that cap gets lowered each year to form a new tax baseline. This is known as the "ratchet effect." When the economy recovers, the municipality may only keep those dollars that match the CPI increase plus any population growth over the previous year regardless of the fact that population may have stayed stable over the recession and the CPI may not be growing at the same rate as the economy. In the latter part of the 90s, economic growth far exceeded inflation. In that case, municipalities had to return revenues over the cap. This led many communities including Boulder to de-Bruce. However, as noted above, Boulder did not de-Bruce its entire property tax. Therefore, when the economy expands, the revenue from property taxes cannot expand at the same rate. The inability to retain excess property tax revenues generated during good economic conditions, coupled with the lower taxable base due to poor economic times, results in revenue instability.

POLICY CHOICES

Revenue instability is also a result of various independent policy decisions with interrelated and compounding effects. Earmarking, sunsets, land use decisions, and the costs of growth are the specific policy choices that have had revenue de-stabilizing impacts.

Earmarking

Earmarking is the practice of dedicating a revenue source to a specific expenditure item. The General Fund is the accounting home of revenues not dedicated to a specific purpose. This money can generally be used for any government operation as determined by council. Earmarking forbids council to move money to fund programs and service expenditures other than the specific purpose established by community election, ordinance or council vote. As of 2008, Boulder had earmarked more than half of its 3.41 percent sales tax:

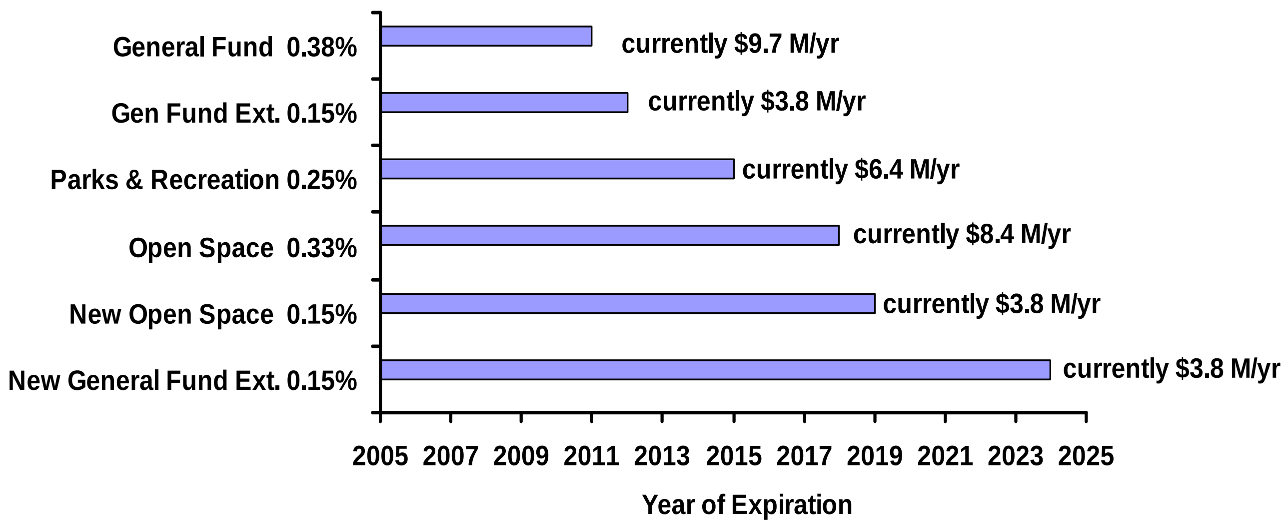
0.60% for Transportation
0.88% for Open Space
0.25% for Parks and Recreation
0.15% for certain programs within the General Fund

This earmarking is effective in garnering approval for new revenue for much loved programs or services, but it has a huge impact on the ability to run the city government as a single organization with efficiencies, priorities and best practices considered agency-wide. By way of example, in the 2007 budget, the Open Space Fund, which is 93 percent dependent upon sales and use tax, saw a 5.07 percent increase in revenues and was able to fund most of its Master Plan's Action Plan and some of its Vision Plan (see Appendix F for descriptions of Master Plan and Business Plan terminology). The General Fund, on the other hand, was forced to keep police officer positions unfilled in order to pay for maintenance of its fleet. Earmarking reduced the ability to transfer funds such that organizational priorities might take precedent over the priorities of special revenue funds.

Earmarking exacerbates instability because it limits flexibility. The inability to move dollars around and address needs on an organization wide basis is impaired by this practice. However, this assumes the dollars to be moved around would have existed if earmarking was not in place. This may be a false assumption as the voters' approval was conditional upon receiving the specific service promised during the election.

Sunsets

A common practice associated with earmarking is establishing a date in which the tax will expire. Like earmarking, this is a tactic to generate greater support for the tax initiative. The city of Boulder has six sales tax initiatives that will expire prior to 2030. The graph below illustrates these sunsets and identifies the amount of money that each generates in 2008 dollars.



These six taxes represent 41 percent of the sales tax rate in Boulder. In 2008, this corresponds to a $36 million of city revenue. As an example of the magnitude of the sunsetting sales taxes, this amount of revenue equates to more than the entire Fire, Housing and Human Services and Library budgets combined. What makes this situation problematic from an operational standpoint is that three of these taxes are for the General Fund. The General Fund is the principal financial home to pay for administration, Police and Fire, as well as provide the majority or significant operating budget to departments such as the Library, Parks and Recreation, Planning and Development Services, and Housing and Human Services. These core services are expected by residents and are further expected to be provided in their base taxes (i.e. property tax, one percent general fund sales tax, and .6 percent transportation sales tax). The fact that Boulder has become so dependent upon expiring sales tax to provide a host of services leads to revenue instability. On the flip side, sunsetting sales tax may provide an opportunity to redirect that tax capacity to problem solving purposes.

Land Use

Land use decisions have also had the unintended consequence of contributing to revenue instability. As noted in the Colorado Public Finance subsection, in our current public finance system it is advantageous to focus upon growing jobs and businesses rather than population, as businesses, particularly retail oriented, produce far more revenue than residents. As noted in the Gallagher section, businesses make up 20 percent of actual values in Boulder but pay 53 percent of property taxes. Businesses and their commuters also generate approximately 35 percent of the sales tax. And the trend of in-commuters is expected to grow. The Boulder Valley Comprehensive Plan projects by the year 2030 there will be 11,700 more residents, but 22,700 more jobs. The totality of this business weight is that the Boulder economy is more sensitive to variations in the business cycle.

Moreover, the retail sector, which contributes the sales tax, is not fully diversified and has some growth weaknesses. Specifically, Boulder has less value retail. This is retail that is able to provide budget pricing through high volume sales. It also is sometimes referred to as “big box” or “large format” retail. Value retailers are large sales tax producers and are under represented in Boulder. Fortunately, Boulder has high representation in specialty (Pearl Street) retail and a renewed anchor in comparison (Twenty Ninth Street) retail. However, population drives retail growth. While population is expected to grow by 11,700 people over the next 22 years, this is quite modest and consequently leads to modest growth in sales tax projections. A more complete overview of retail can be found in Appendix B.

<u>Costs of Growth</u>

The debate regarding the cost of growth is not unique to the city of Boulder. It is a controversial issue that is debated across the United States. There are two major components of growth that impact the funds included in this study; capital costs and ongoing operating costs.

The following is an excerpt from the Boulder Valley Comprehensive Plan.

> When permitting additional development or redevelopment, the city will consider whether public facilities and services are adequate to reasonably maintain current levels of service or service standards given the impacts of such additional development or committed funding sources for such adequate facilities are sufficient to ensure their provision in a timely fashion. Growth will be expected to pay its own way, with the requirement that new development pay the cost of providing needed facilities and an equitable share of services including affordable housing, and to mitigate negative impacts such as those to the transportation system.

In the city of Boulder, the most significant financial contributions toward the capital costs for new growth as it relates to the funds covered in this report are collected through the one time payment of development excise taxes (DET) that have been approved by the voters. The amount of the tax increases each year by the increase in CPI for the previous year. Due to the requirements of TABOR any increases over the inflationary amount would have to be approved by the voters within the city. The concept of the tax is the amount paid will buy into the existing capital assets of the city at an amount equal to the impact of the new growth. The 2008 approved budget includes funds to update the DET costs. Ongoing operational costs for new growth are contributed through increments in sales tax, property tax or other taxes and fees paid to the City.

If the DETs and new incremental revenue are equal to the new costs of required capital and ongoing operating costs then the net impact of the new costs of growth should be zero. Therefore, there would be no impact the stability and balance of city revenues. If there is a shortfall in either capital or operational revenues then current contributors to the revenues are subsidizing the new growth. If excess revenues are collected then new growth is contributing excess amounts to the City. The BRC found that the current costs should be reviewed since the inflationary increases allowed each year have been insufficient to keep up with actual costs and the DET amounts are falling farther behind the actual costs.

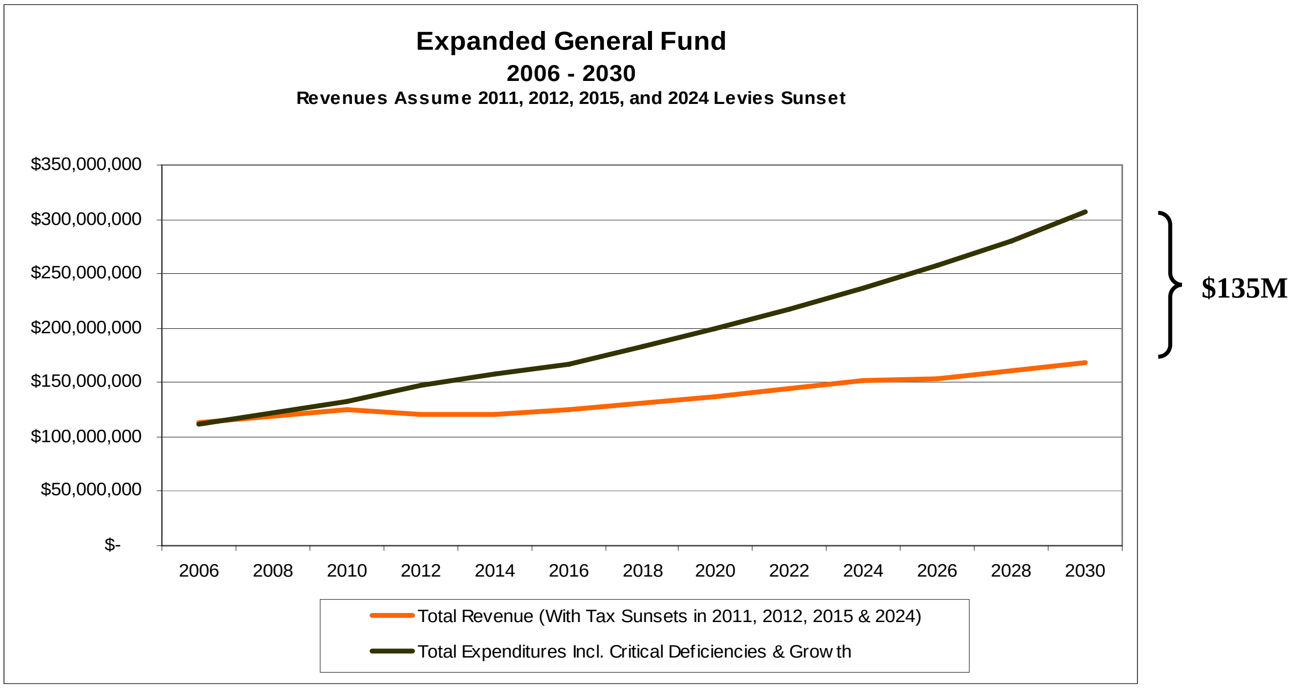
REVENUE INSUFFICIENCY (the Gap)

The Blue Ribbon Commission was tasked with addressing revenue instability and identifying new revenue that accomplishes public priorities. Upon exploring this concept, the commission felt that the task was as much about program and service instability as it was revenue stability. The historic revenue gains of the late 1990s led to significant program and service enhancements. The corresponding revenue decline in the early part of this decade led to significant cutbacks in personnel and maintenance driving service levels down and making programs very fragile. Consequently, it seemed logical to the commission that the scope also be about program stability and setting the framework for funding the current bundle of services, as well as master plan desires for service and program enhancements.

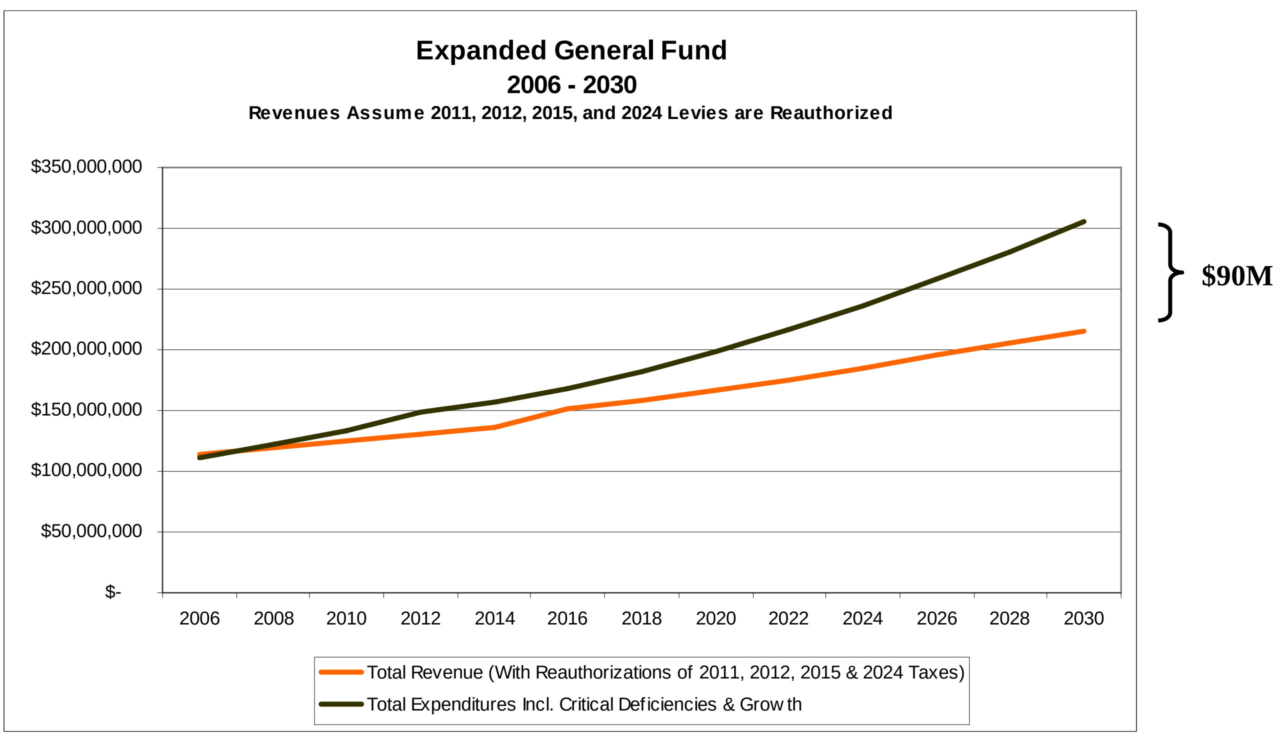
The commission worked with two economists (William Kendall and Phyllis Resnick) to project revenues and expenditures from 2006 through 2030. Without detailing every assumption that went into these forecasts (details can be found in Appendices C, D and E), the commission essentially projected growth using the 2030 Boulder Valley Comprehensive Plan, various inflation factors that corresponded with their sector, and service consistency. In other words, we assumed the same bundle of services provided in 2006 would be provided in 2030. However, in order to provide the same bundle of services in 2030, the 2006 base projection was adjusted to include funding for a few critical city functions that were either unfunded or significantly under funded in 2006. The four functions are essential to continue providing the same services to the community and are referred to in this report as Identified Critical Deficiencies (see Appendix J for more detail). The total estimated annual costs of the ICDs are $3.6 million per year. The Identified Critical Deficiencies include:

- Fire Apparatus Replacement
- Software Replacement
- Facility Maintenance
- Facility Energy Costs

The magnitude of this gap can be scaled in a couple of ways. If the sunsetting sales taxes are not renewed, we face a gap between revenues and expenditures of approximately $135 million per year in the year 2030, as depicted in the chart on the following page.



Another way of looking at this is that revenues are generally projected to grow at approximately three percent per year whereas expenditures are projected to grow at a approximately four percent per year. This sounds like a small difference. However, expenditures are growing at a rate one-third faster and compounded each year for 24 years. Even with renewal of all expiring sales taxes, we still face a gap of approximately $90 million per year in 2030, as depicted in the following chart.



The reasons for the insufficient revenue can be traced to demographic shifts and inflation. The reasons for the outpacing expenditures are the ties to the inflation associated with the inputs needed to provide municipal government services.

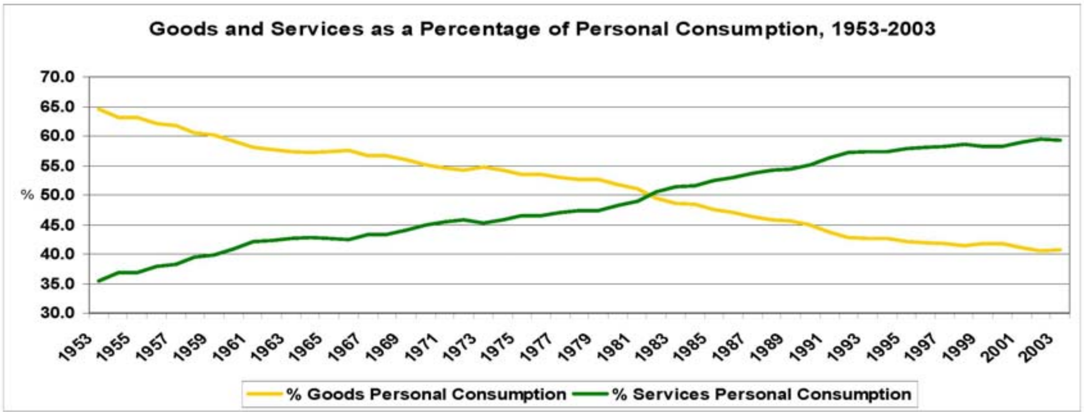
Inflation and Consumption of Goods/Services

Inflation associated with the bundle of goods and service provided by the city of Boulder will grow quicker and greater than revenue. This is because the key expenditures in the Boulder bundle of services are staff (who have health insurance, pension costs and labor competition with multiple municipalities in the Denver metro market), utilities (gas and electricity to run office buildings, recreation centers and libraries), and oil and cement based inputs (pavement and sidewalk construction, fleet use). The inflation rate of these inputs is far outpacing the inflation rate of sales and use tax growth. In the expanded General Fund (noted in the graph above) the combined inflation rates were projected at an average of four percent per year. This is far below the rates we have seen in the past five years, but appeared more sustainable over a 20 year period.

On the revenue side, sales and use tax inflation is projected to grow at approximately three percent per year. This is attributed to a decreasing productivity associated with sales tax. Part of that is inflation while part of that is demographic shifts.

When sales taxes were first implemented as a public finance revenue tool in the 1950s, durable goods as a percentage of personal income was quite high. Consequently, sales taxes were assessed on durable goods. Sales taxes were not, and are not, assessed on services. These are things such as health care, accountants and lawyers. However, it also includes things such as labor on vehicle repairs, landscaping services, hair care and health clubs. Since the 1950s, our economy has moved to service based consumption. As the graph below indicates, services now make up 60 percent of our personal consumption. So in short, we are taxing an industry that is making up a smaller and smaller percentage of our economy. Thus, sales tax becomes less productive as a revenue tool.

Consumption of Services is Growing



Source: Bureau of Economic Analysis

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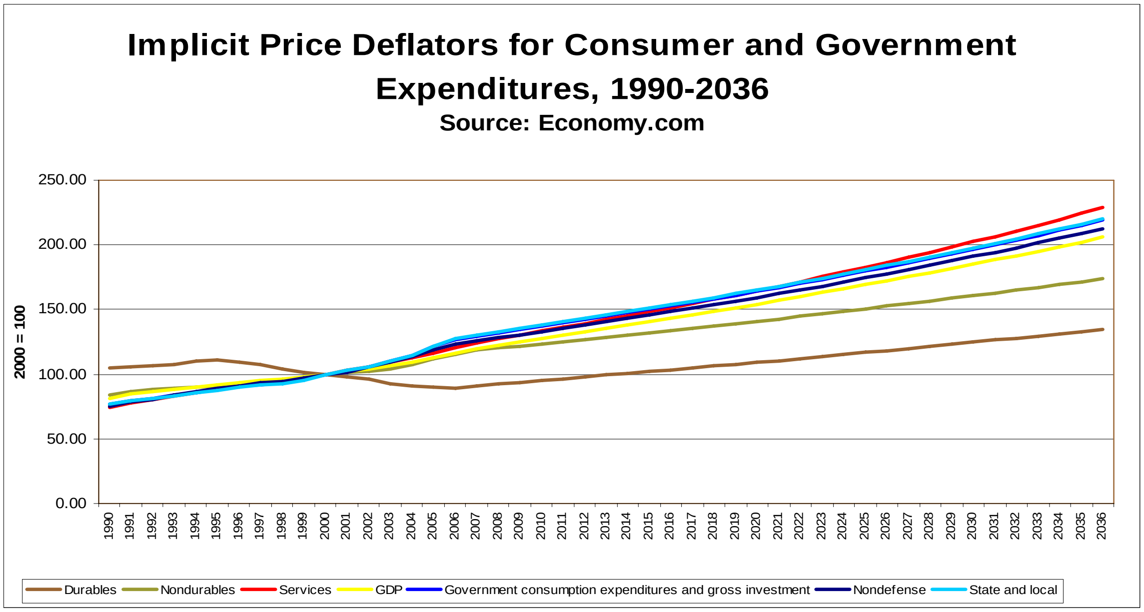
This declining productivity is compounded by the fact that inflation on durable goods is also quite flat. By way of example, think of the cost of your personal computer. The hardware has essentially cost the same or decreased over the last 10 years, however, the machine's capabilities have grown geometrically. On the service side, simply think about the cost of health care over the past 10 years. The graph below illustrates this difference. Consequently, we are not only taxing something that is making up a smaller and smaller portion of our economy, the inflation rate on those goods will lag the overall inflation rate, contributing to an even less productive sales tax.



Demographic Shifts

Boulder, like most cities across the country, is experiencing significant demographic shifts. The population of the city is getting older. Boulder residents age 45-59 increased from 15 percent of the total population in 1990 to 22 percent in 2000. Boulder's median age is expected to peak at 51 in 2030 compared to 35 in 2000. An older population generally spends less money on sales and use tax eligible goods and more on non-taxable services such as health care. An example of this impact on revenue can be seen when comparing a household with occupants in their late thirties or early forties who will generate approximately $250 a year in city sales tax compared to a household with 65 year old members who will generate only $150 per year. Understanding that Boulder has approximately 45,000 households, the impact could be significant.

Boulder's population is also becoming wealthier. The Boulder-Longmont median family income was $81,600 in 2006 compared to $65,400 for the state and $59,600 for the nation. Wealthier residents generate more sales tax. Households in the lowest 20 percent of the income demographic generate about $100 per year in sales tax compared to $400 per household for those in the highest 20 percent.

An older population and a wealthier population create a teeter-totter condition on revenue generation. In general, the two are equally weighted, but either demographic shift could pull revenue generation associated with sales tax in their respective direction.

In the middle of this teeter-totter is another phenomenon in Boulder - increasing diversity and a poverty level higher than the national average. Specifically, a rapidly growing immigrant and non-native English speaking population is emerging in Boulder. As an example, Boulder's Latino population doubled from 4.5 percent in 1990 to 8.2 percent in 2000 with half born outside the United States. In 2000, 13.4% of Latinos, 69% of those identified as White (non-Latino), and 10.3% of those identifying in the "other" race ethnicity group in Boulder were below the poverty line; 14% of Boulder's total population is below poverty level – higher than the national average (estimated in 2002 in 12.1%). This places these groups' revenue generation in the lowest 20 percent of income. Furthermore, the type of retail (which generates sales tax) most desirable for the lowest 20 percent income bracket is value retail – a component of our retail mix that is significantly under-represented in Boulder. Value retail, also know as "big box" or "medium box" retail, sells at lower prices but at considerable volume such that these types of businesses generate significant sales tax revenue.

The diversity demographic shift is likely to raise questions regarding regressivity of taxes. This is the aspect of taxation in which people with lower incomes pay a higher portion of their income for taxes. Regressivity in the current Boulder revenue structure is most likely found in the sales tax on food. The food sales tax represents 13% of total city sales and uses taxes ($10,274,234 in 2006) and is one of the most stable and substantial elements of Boulder's revenue stream. To try to offset some of this impact the city offers a sales tax rebate on food to qualifying individuals.

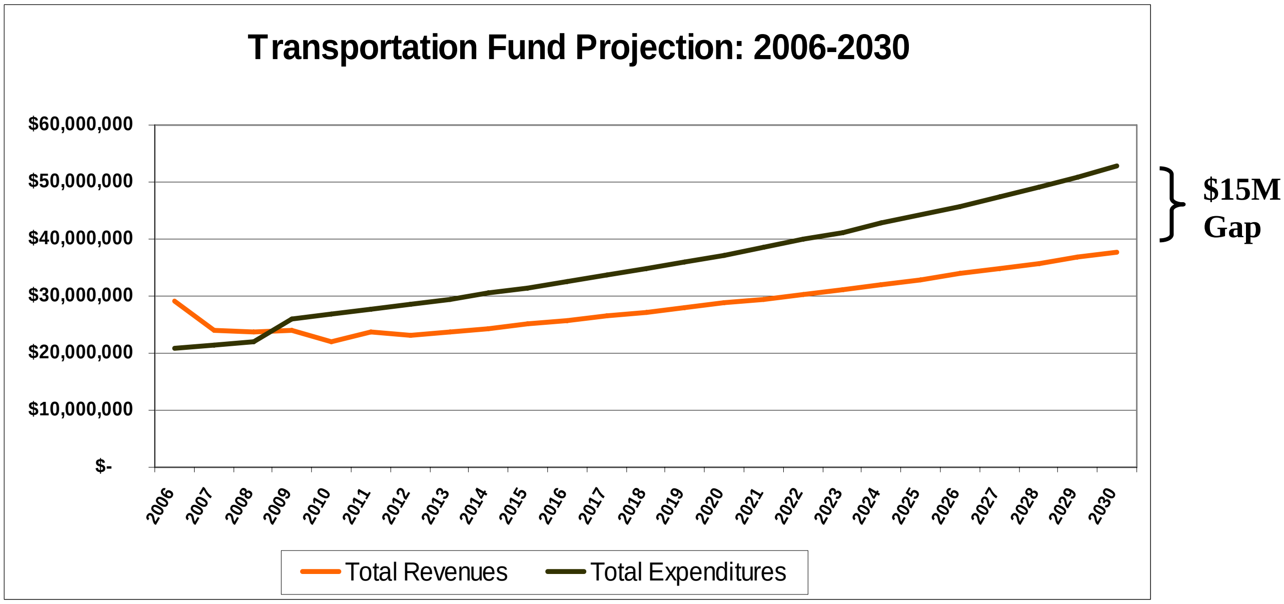
Another demographic shift affecting the revenue gap is real estate. Housing prices in Boulder have appreciated an average of six percent per year over the last 20 years. However, revenues associated with property taxes have not kept pace. The link between real estate and government revenue is most clearly articulated in the property tax. In a non-TABOR environment, the same mill levy (tax rate) should generate more money. With the adoption of the Taxpayers Bill of Rights (TABOR) at the state level in 1992, such revenue growth did not occur. Boulder voters could elect to lift this limit, and in 1998 they did for the two mills associated with public safety services, but not for the entire 11.981 mills. Consequently, the city has had to reduce its property tax rate by 23 percent to stay within its TABOR cap. In other words, revenue growth associated with property taxes has not been as productive as it could have been had Boulder been fully de-Bruced.

With these inflation and demographic conditions, the revenue tools Boulder has historically relied upon are becoming less productive. Consequently, **revenue growth** over the planning period studied by the Blue Ribbon Commission **will not keep up with expenditure growth**. As noted above, we anticipate an average expenditure growth of four percent per year and a corresponding three percent growth in revenue per year over that same period in order to keep the same bundle of services at the same service standard. For the expanded General Fund, this creates a gap of $90-$135 million per year in the year 2030 depending upon sales tax renewals. Other funds have variations on this premise.

The Gaps' Affect on Other Funds

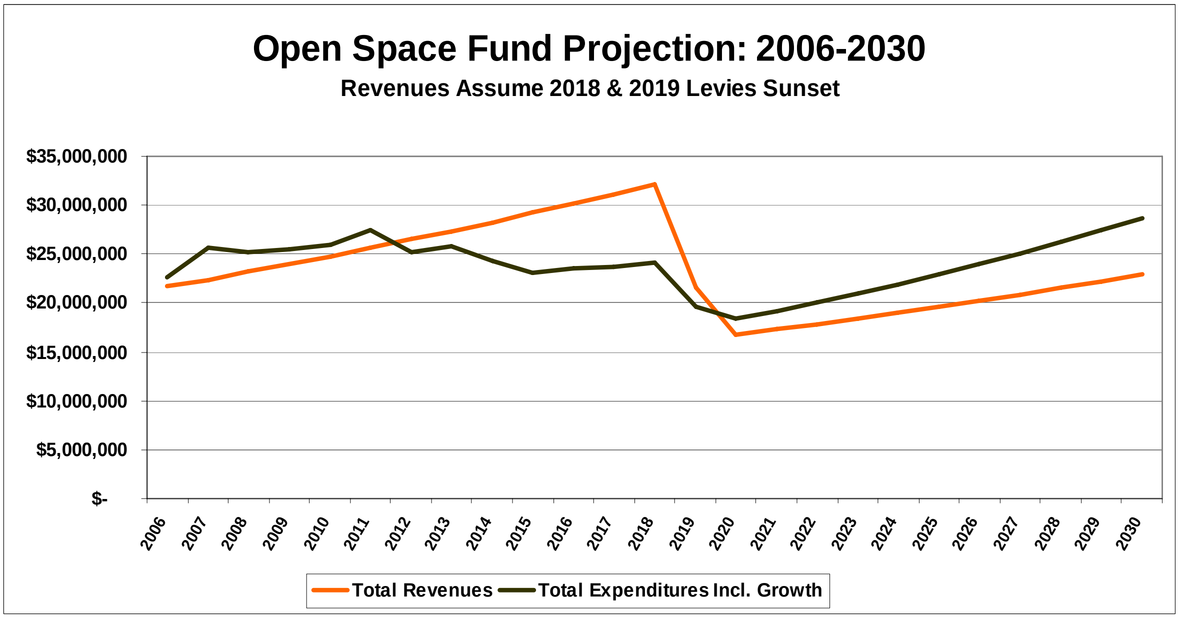
When looking at transportation revenue and expenditures, the gap widens even quicker. This is because transportation costs are expected to grow at twice the Denver-Boulder – Greeley CPI rate. Compound this over 24 years and we are facing a transportation gap of $15 million per year to essentially maintain the system. Our growth assumptions say we will have another 11,000 residents and 22,000 commuters on that transportation system.

This will certainly tax the road system in Boulder. However, we have not accounted for demand management infrastructure such as Bus Rapid Transit (BRT) and commuter rail associated with Fast Tracks.



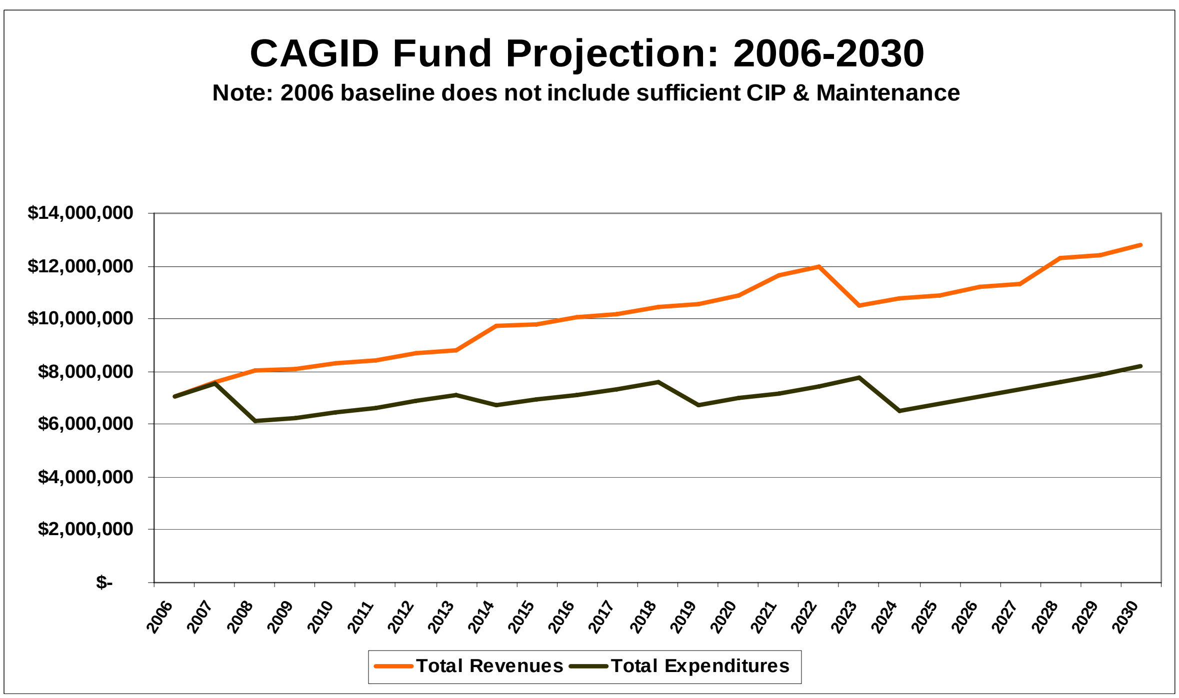
It is important to note that some commission members expressed skepticism that even fully funding this gap would result in the maintenance of the transportation service level we experienced in 2006 due to significant uncertainties in the costs and extent of transportation improvements, and the difficulty of implementing large roadway expansions.

Conversely, when looking at Open Space and Mountain Parks (OSMP) and the Central Area General Improvement District (CAGID) funds, there was much greater optimism about their financial future. The OSMP gap is fairly narrow. First, expenditures are based upon the 2006 bundle of services. So the expenditure line does not include any growth associated with implementing the Action and Vision Plans of the Visitor Master Plan which existing sales tax revenue are anticipated to significantly address. Second, when the OSMP sales taxes expire in 2018 and 2019, the debt will be retired and plans do not call for any further land purchases since the approved acquisition program should be complete. According to OSMP staff, the 0.40% permanent sales tax should be sufficient to fund ongoing maintenance needs.



$5.7M Gap

The CAGID principal revenue source is parking revenue (does not include revenue from parking fines). The revenue line assumes the periodic increase in parking rates. The expenditure line does not include funds used for capital improvements which are planned to maintain the existing infrastructure. So while the fund is healthier than others, the positive gap shown is somewhat misleading.



$4.6M Surplus

As a result of this information, the BRC decided to focus upon the expanded General Fund and the Transportation Fund. The OSMP and CAGID funds did not receive any further attention in terms of trying to solve this revenue gap problem.

SUMMARY

The city of Boulder is facing significant challenges in providing the same bundle of services in 2030 as it did in 2006 due to unstable and less productive revenue sources. Moreover, inflation associated with inputs is largely out of the control of the city and will exceed revenue growth. The scale of the problem is significant and becomes more significant each year as inflation rates compound and revenue streams expire. Therefore, the balance of this report will focus upon what tools are available to address this situation and the recommendations the BRC is providing to council as guidance for moving forward.

2 The Solution Framework

Chapter one outlined the state of our revenue structure and the resulting projections of these systems in the year 2030. These findings significantly changed the direction of the Blue Ribbon Commission's (BRC) work. Whereas the original charge focused upon revenue stability and the renewal of expiring sales taxes, it was anticipated that such work would enable the council to also pursue implementation of the departmental master plans. Instead, the focus is upon preventing the erosion of services from their 2006 service level while also trying to achieve that original charge. The BRC wrestled with several approaches to crafting solutions. We settled on a framework that looks at the problem from a policy, amount and a structure perspective.[2]

PRINCIPLES

Recognizing the "revenue stabilization" charge, the BRC first established a set of principles that articulated just such a situation. The following were adopted as our ideal revenue structure:

1. Earmark for capital needs only
2. Don't sunset revenues for ongoing operations and maintenance
3. Maximize flexibility
4. Reserve in good years to ensure stable services
5. Determine basic and core services in order to associate the appropriate revenue tool
6. Closely align who pays and who benefits
   - Make proper use of taxes and fees to accomplish
   - Clearly identify subsidies
7. Use the right capital financing tool for the right situation
   - Pay as you go versus debt financing
   - How to make the best use of the time value of money
8. Maximize diversification
9. Revenue system should be easy to administer
10. Revenue system should be equitable
11. Growth should pay its own way
12. Revenue rates must be regionally competitive

These principles set the stage for a series of policy discussions regarding how to manage the large and complex finances of the city. Because the city will need to ask for large sums of money in order to close the gap or fund enhanced programs and services, there needs to be a demonstrated effort to the community that: 1) these solutions solve the problem; 2) the city has explored efficiencies within its operations and is implementing best practices; and 3) the municipal corporation has eliminated practices that create wealth in one area of the organization and chronic shortfalls in another. Crafting of these

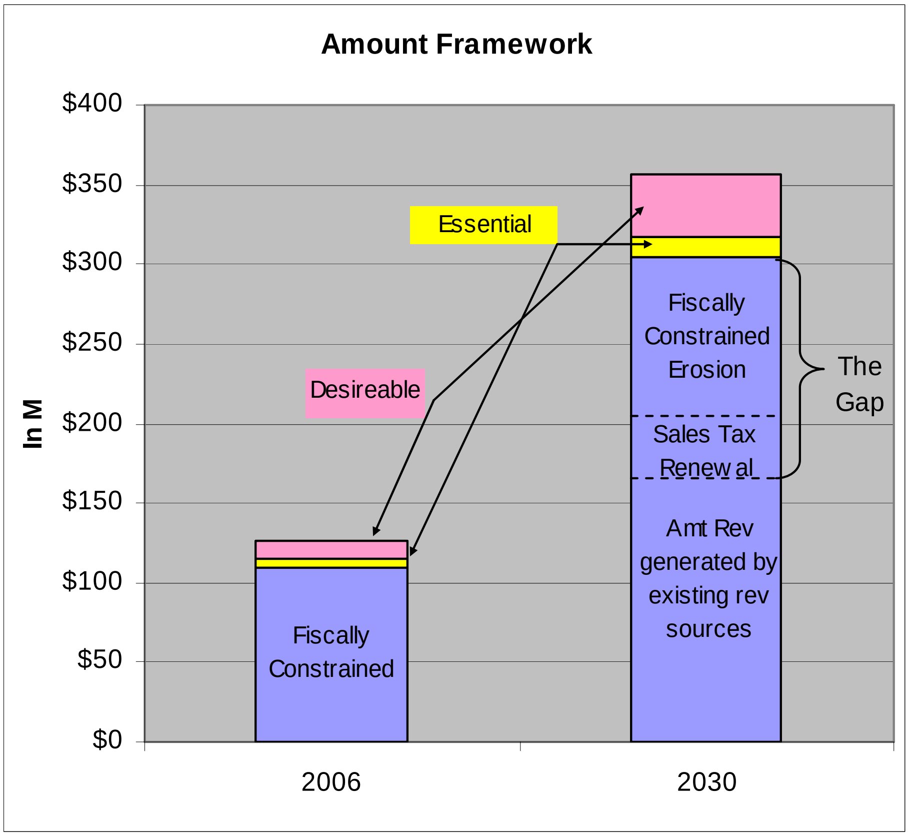
[2] As a formatting note, bold text in this chapter represents additional findings that are incorporated in the solutions chapter.

various policies over the course of the commission work led to a context in which to advance an amount and/or structure solution.

AN AMOUNT FRAMEWORK

As noted in the findings (Chapter 1), in order for the city to provide the same bundle of expanded General Fund services at the same service standard in 2030 as it did in 2006 will require an additional $135 million per year more than what can be generated by existing revenue sources. If all the expiring sales taxes within the Expanded General Fund are renewed, that deficit drops to $90 million. These numbers are known as "the gap." One way of addressing this problem is to look at various revenue tools that will generate $135 million more in the year 2030. This is an "amount" approach to the problem. In other words, we have identified how much money we need and the solution could simply be to devise a plan that raises an equivalent dollar amount. An amount-focused solution is often associated with capital projects. For example, we want to build a fire training center, conference center or develop a park. We know it will cost $X. We submit a ballot measure to the voters. If they approve and all calculations are accurate, the revenue tool raises the necessary amount and the project is completed. In this way, the gap is an amount problem that necessitates an amount solution.

Additionally, funding of the various departmental master plans has also been looked at as an amount problem thus far. The standard template for a departmental master plan calls for an investment strategy (see Appendix F for definitions of "Essential" and "Desirable" and other Business Plan terminology). The investment strategies look at what can be accomplished in a fiscally constrained financial environment, an action plan funding level or a vision plan commitment. The fiscally constrained investment strategy assumes that funding will remain at a level such that the existing bundle of services and existing service standards will be maintained. Prior to the BRC analysis, it was anticipated that revenue inflation would keep pace or

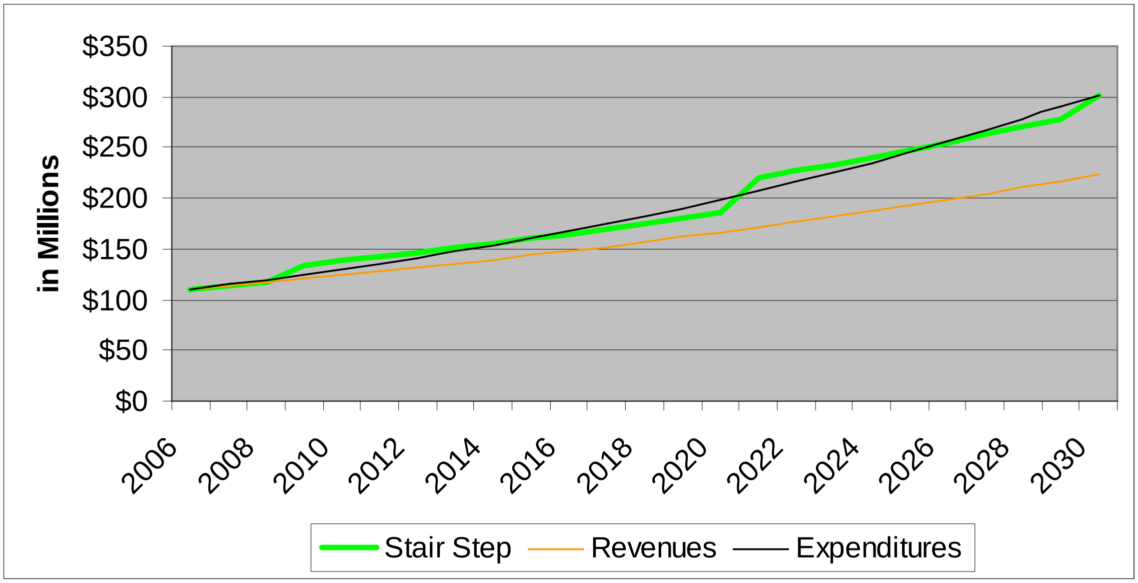


outstrip expenditure inflation enabling fiscally constrained to remain an easy to achieve baseline. Post BRC analysis, it is realized that in order to obtain the service levels identified in the fiscally constrained investment plan, the gap between revenue and expenditure inflation must be eliminated first. To fund the action plan or the vision plan, it will take revenues at a level greater than the gap.

Recognizing that the basic gap (not including the additional essential and desirable programs) in 2030 required as much as $135 million per year, the City Manager's Office, in conjunction with an assortment of department directors, reviewed the essential and desirable services and programs found within each action plan of departments in the expanded General Fund or Transportation Fund. The review group asked the departments to standardize their plans over a 10 year planning horizon as this was generally the average timeline of these plans. This resulted in the submittal of $12 million in essential programs and $37 million in desirable programs (all in 2008 dollars)[3]. The group reviewed these requests and winnowed the list down to $5 million in essential and $12 million in desirable or $17 million total in 2008 dollars (these additional dollars would become known as the enhanced package). Converting the 2008 dollars to 2030 values, the amount translates into $40 million. In the year 2030, the amount problem is now $175 million per year more than what is anticipated to be generated.

So how to solve an amount problem? Particularly a non-capital one with a long planning horizon. The typical answer is the stair-step approach. The stair-step approach notes that service levels are currently behind standard. It then determines an amount that should get the service back to an acceptable service standard now and for perhaps the political life of the council and/or city manager. The voters approve and expenditures jump above the trend line for a period of time. During such time, the underlying revenue problem of three percent revenue growth versus four percent expenditure growth slowly erodes the purchasing power and the service standard drops back below an acceptable level thus prompting the case for further revenue increases. The graph below illustrates the stair-step.

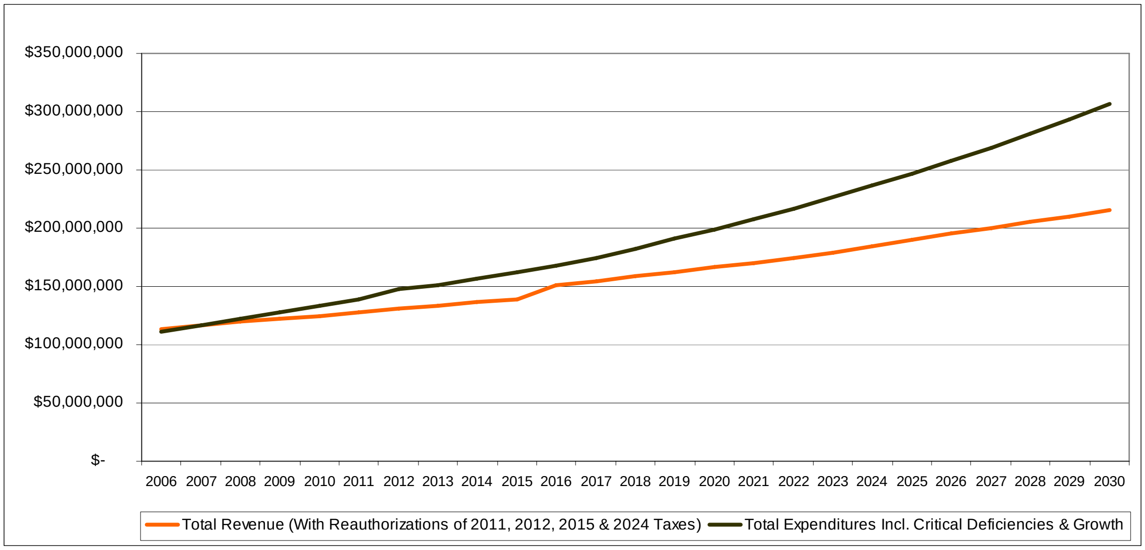
[3] The BRC work commenced in July 2006. Since that time, two budgets have been adopted. Consequently, the BRC and staff began using 2008 as a base year.



The black line indicates the cost of the service at the acceptable standard. The orange line indicates revenue growth assuming no change in existing rates. The green line shows expenditures in the stair-step approach. This approach is certainly better than the alternative if one is a fan of the services provided, but also leads to a challenging cycle for all participants. One method of delaying the cycle is to create a ballot measure that periodically ratchets up the tax rate. As an example, the voters in 2008 vote to increase the tax rate by some increment believed to offset the erosion every so many years. The measure is voted upon all at the front end. This puts all the political challenge on the front end, but may be too big to overcome and additional legal research would have to be completed to determine if this can be done in Colorado due to the one item per ballot issue requirement. So what is the alternative?

STRUCTURAL FRAMEWORK

The city has a number of revenue tools such as sales tax, property taxes and fees that together make up our revenue structure. We learned from Chapter 1 that Boulder's current structure is primarily dependent upon sales and use tax which is quite volatile and becoming decreasingly productive. Specifically, sales and use taxes are expected to grow at about three percent per year on average over the next 22 years. This growth rate accounts for both new retail outlets that sell sales-tax eligible goods and it also accounts for the inflation in the price of those sales tax eligible goods. Expenditures during the same projection period are expected to grow at four percent. This also has a component in which the service units increase to maintain the same service standard, and it also accounts for the inflation associated with these goods. In both cases the inflation is the heavier weight than the pure expansion. Chapter 1 explains the reasons for this in some detail. This inflation rate differential is captured in the below graph (previously shown in Chapter 1), which assumes renewal of sunsetting sales taxes:



In order to solve a structural problem, you change the structure. In short, move off the orange trend line (which is growing at three percent) and onto the black line (which is growing at four percent). Just changing the sales tax rate will not accomplish this because the underlying foundation of the sales tax is not capable of producing returns in the four percent range. Changing the sales tax rate essentially translates into an amount solution rather than a structure solution. Therefore, different revenue sources must be examined.

The Blue Ribbon Commission looked at over 70 different revenue tools (see Appendix G). Of those tools, only property taxes and occupational privilege taxes (i.e., head tax) could generate the amount of money that is comparable to sales tax. Of those two taxes, the property tax has shown the greatest potential for sustained revenue growth at or above four percent.

Dr. Richard Wobbekind, from the University of Colorado Leeds Business School and a member of this Blue Ribbon Commission, and his colleagues recently conducted some research on housing in Boulder. One of their underlying findings is that real estate values in Boulder have grown an average of six percent per year for the past twenty years. Budget staff examined the revenue growth of property taxes during the last 10 years and found an average growth rate of four percent per year. The TABOR constitutional limitation that is still in place on most of Boulder's property taxes accounts for the difference in the growth rate between the real and the assessed values. Therefore an increased dependence upon property taxes can affect a real move to the orange trend line in the graph.

Additional research by budget staff also noted that fees in the last 10 years have averaged a 5.9 percent increase per year. This reflects two important aspects of this revenue source. First, fees are in the control of council and may be increased by ordinance rather than community vote. Second, in times of economic downturn, such as was experienced in the first half of this decade, governments rely more heavily upon fees. Therefore, along with property tax, a greater dependence upon fees represents a revenue structure more likely to keep pace with expenditure inflation

Two other sources have potential to diversify the revenue structure and grow at an inflation rate similar to that of expenditures. First is sales tax on services. As noted in Chapter 1, sales tax is currently assessed on durable goods. Durable goods have a very low inflation rate whereas services have an inflation rate in excess of four percent. This means, that **adding services to those items eligible for sales tax would enable the sales tax to migrate towards the expenditure inflation trend line**. An approximate amount of revenue that could be generated by sales tax on services was not known as of the writing of this report. If it is determined that this possible revenue option should be further considered, a study can be commissioned to determine what revenue could be generated by including selected services in the tax base of the city. Additional research would also need to be completed to determine if this change would be considered a tax policy change to the current Boulder Sales and Use Tax Code. If it is, it would require a ballot issue due to TABOR.

The last revenue tool that could cure the structure problem is the Real Estate Transfer Tax (RETT). This is a tax assessed on real estate at the time it is sold. This revenue source is the lifeblood for many mountain towns in Colorado. These taxes are paid by the purchaser of real estate (typically a non-resident) based upon the value of the transaction. There are significant real estate transactions that occur in Boulder each year. Because real estate values in Boulder have grown an average of six percent per year over the last 20 years, the inflation rate associated with this revenue tool would more closely approximate the expenditure inflation trend.

As this subsection details, in order to solve the problem long term, a structural solution is required. A structural solution will most likely increase dependency upon property taxes and fees with potential for a sales tax on services and/or a real estate transfer tax. Unfortunately, when TABOR passed, a RETT is prohibited and will require an amendment to the Colorado Constitution, making it a greater challenge to employ this tool. Even with these tools in place, the scale of the gap is so significant as to still necessitate an amount solution in company with a structure solution.

SUMMARY

The framework necessary to solve this problem will require policy changes that implement best financial practices, diversification to revenue tools whose inflation rate more closely mirrors expenditure inflation, and periodic amount stair-steps. The Blue Ribbon Commission's recommendation is therefore built upon this framework.

3

The Tools

Chapter 2 outlined the framework selected by the Blue Ribbon Commission (BRC) to solve the gap problem and offer opportunities for implementing departmental master plan program and service enhancements. Prior to outlining a set of sample revenue options or scenarios within this framework, the BRC wanted to explain the tools considered and employed in those programs. The tools take one of two forms - a policy or a tax/fee.

POLICIES

Money alone will not solve the financial challenges facing the city of Boulder. Therefore, amount and structural solutions will only be successful if implemented in an environment governed by sound fiscal policies. The BRC offers a set of fiscal policies that can serve as a starting point for the city to create and/or maintain that environment, and recommends that the council further analyze and fine-tune them

General Policies

1. In the absence of four percent revenue growth, trade-offs and reductions must occur annually.
    - This policy is purposely listed first as a grim reminder of the state of affairs. Taking no action to solve the problem is an option, but it will result in decreasing service standards or lost programs. The BRC cannot emphasize enough that this is the primary finding of this study and therefore, this policy must guide all further finance related action by the city.
    - Remember, four percent revenue growth keeps you even.
2. New services must have a corresponding gain in revenue or productivity, otherwise trade-offs will be required to add any new services.
    - This is essentially a corollary to the first policy. There will always be demand for new or improved municipal services. The current state of affairs does not enable such enhancements without a corresponding increase in revenue or productivity.
3. Councils should consider that new services and programs can obtain funding by reducing or eliminating funding for existing services that may no longer serve public needs or may be of lower priority.

    This follows on policies 1 and 2, reminding decision-makers that new services may not always require new sources of revenue. Existing services and programs should periodically be measured against new community needs and desires, and thus may be cut or reduced. Service standards may also need to be re-examined over time.
4. Diversify, Diversify, Diversify
    - The BRC debated establishing benchmarks to guide the percentage of revenue that should come from any one source of revenue, but decided in favor of the flexibility principle with an incontrovertible mandate to diversify the city's revenue sources.

    - The percent of revenues received from retail sales taxes (currently approximately 44 percent of the Expanded General Fund), should not increase without a substantial rainy day fund to offset inevitable market downturns.
5. Taxes and fees should be comparable to surrounding municipalities;
    - While Boulder offers a unique quality of life, its location in a major metropolitan area demands that its financial policies cannot be developed in isolation.
    - Taxes and fees need to be competitive with surrounding jurisdictions in order to preserve an employment, retail, and residential base necessary for a sustainable economy.
    - Of particular note to the BRC was the comparison of sales tax rates and of development excise taxes. Both have significant revenue generating capabilities, but should exist in a comparable form so as not to negatively affect the Boulder economy.
6. Maintenance of infrastructure should not be tied to an expiring revenue source;
    - In reviewing expenditure issues associated with expiring sale taxes, the BRC noted occasions where the sales tax was funding operation and maintenance functions in addition to debt service payments.
    - If the corresponding sales tax is not renewed, the program or service associated with the capital improvement plus the capital improvement itself will face a rapid decline.
    - This represents a false promise to the voters that the ballot item really has a sunset because there is not adequate growth in other revenue sources to absorb the additional operational and maintenance needs of new capital projects.
    - Furthermore, such a condition places those service or program users in a tenuous situation of losing a good that was seen as a perpetual service enhancement at the time of the election.
7. Funding of personnel should not be tied to an expiring revenue source;
    - For the reasons noted in policy 6.
8. Earmark funds only for capital purchases and construction if possible;
    - For the reasons noted in policy 6.
9. Different capital financing methods are appropriate for different situations;
    - Pay as you go most appropriate when:
        - Funding maintenance and relatively minor capital projects. The city's FAM (Facilities and Asset Management) division currently uses this mechanism, but does not fund major capital replacement.
        - Low inflationary times
    - Debt financing most appropriate when:
        - Major capital construction projects or purchases
        - High inflation situations
        - Immediate or lost opportunities
        - Very low financing costs

10. Revenue expansion through economic development opportunities may reduce the need for future tax increases.
    - Economic development remains a critical part of any financial future for Boulder. Growing the (economic) pie will increase revenue into city coffers. However the net financial impact on the city needs to be analyzed to determine if such development also results in long-term impacts, infrastructure needs, and expenditures.
    - The fewer changes to the revenue structure there are, the greater the need to increase the number and/or scale of the existing revenue producers.
11. Efficiency studies on targeted city operations can be a useful and important tool, and can help justify tax increases for continuing services.
    - While there is great confidence in the city government to exercise good management of tax dollars as evidenced by regular approval of tax increases, those increases have typically been for service enhancements.
    - The increases associated with the BRC work are necessary to maintain services at current service levels. This is a more difficult sell to the voters.
    - Consequently, voters need increased assurances that operational efficiencies have been maximized prior to increased contributions.

Budget Policies

12. Need to think of city as a single company – not multiple financial holdings;
    - The BRC noted the highly segregated nature of the city's finances. The General Fund is seen as the parent holding company where the city manager governs while special revenue funds are similar to subsidiaries with considerable autonomy.
    - There is great disparity among the financial health of different departments as a result.
    - While earmarking limits the flexibility of funds, the General Fund is often looked to for shortfalls or erosion losses for programs that have earmarked revenues creating a compounding effect. For example, a program with an earmarked revenue source finds that energy costs have outpaced revenue gain or the community desires a program enhancement. It is presumed that rather than reallocating within the earmarked fund, the General Fund is responsible for the shortfall.
    - The BRC recommends greater emphasis in budgeting that looks at the health and program delivery of the entire city rather than the individual funds.
13. Reduce number of restricted funds to provide greater budgeting flexibility;
    - For the reasons noted in policy 12.
14. No General Fund subsidies to restricted funds for desirable or discretionary programs when General Fund essentials not funded;
    - In order to bring greater balance to the financial health of different funds, the General Fund should reduce or eliminate transfers to funds which are operating desirable or discretionary programs and services until such time as essential programs and services are funded.

- Such a policy could have a dramatic effect on quality of life departments such as parks, recreation, open space, and libraries, and therefore must be executed with some consideration for preserving an acceptable level of programs and services.

15. <u>No General Fund subsidies to restricted funds whose reserves exceed established benchmarks;</u>
    - For reasons noted in policy 12. However, restricted fund reserves may be appropriately built up over their benchmarks when allocated for approved capital purchases.
16. <u>One-time revenues for one-time expenditures;</u>
    - The use of reserve funds represents dollars that do not have a replenishment source. In other words, they are one-time dollars. Consequently, they should only be spent on one-time expenditures.
17. <u>Expose hidden subsidies either by fully charging taxes or fees and then making use of a rebate tool, or by making such subsidies specific budgetary line-items in order to completely capture the value of those discounts or waivers.</u>
    - In an effort to achieve the revenue principle of equity, taxes and fees often have a sliding scale. In some occasions, fees are completely waived. For instance, if an admission fee to a city program is completely waived, the cost of the program is subsidized by the other users or tax payers in general.
    - Because the fee is never collected, it can be unclear how much of a subsidy or community benefit is being provided.
18. <u>Revenues in excess of certain bond obligations should go to the General Fund regardless of the fund in which the debt obligation is originated.</u>
    - In some cases, the revenue source earmarked to pay debt service generates more money than the debt payment. In those instances, the excess money is maintained in the same fund and appropriated for related programs.
    - This perpetuates the fund focused nature of our current budget structure and does not encourage a more city-wide perspective to program and service needs.
    - This policy would enable the next most pressing appropriation for the municipal corporation to be funded ahead of the next most pressing need of the earmarked fund.
    - Note that this approach is not appropriate for all funds, such as utilities, instances where there are legal requirements for debt coverage, and Open Space, which has ongoing authority to purchase land.
19. <u>Consider consolidation of reserves across the corporation (minus enterprise funds). Consider increasing the ability of using reserve funds for short-term loans.</u>
    - Due to the segregated nature of the city's finance structure, there are reserves associated with each fund. Consequently, when the reserves of the entire municipal corporation are viewed in a consolidated fashion, the corporation looks quite healthy. That is, there is quite a bit of cash-on-hand.

- Such a financial situation posses a challenge when asking for increased taxes or fees from the voters.
- The ability to implement this recommendation will be difficult due to the restrictions governing the earmarked revenues and other legal or current policy requirements found in some funds.

Land Use Policies

20. Conversion of commercial or industrial use land to residential must pay attention to the Gallagher assessed valuation offset now and 30 years from now;
    - As noted in Chapter 1, commercial and industrial property is assessed at more than three times the rate of residential property. If the actual value of the property remains constant in the conversion, the city will see a 73 percent reduction in property tax revenue from that parcel.
    - Recent conversions in Boulder however, have typically seen an increase in actual value of the new residential property greater than three times the previous value. This is due to increased density and the consistent increase in residential property values in Boulder over time.
21. A balance of retail types (value, comparison, specialty and convenience) should be pursued unless revenue sharing can offset;
    - Consistent with policy 4's call for diversification, balance among the categories of retail will produce a more stable revenue system.
    - Boulder has a healthy representation of comparison and convenience retail (see Appendix B for further explanation). Increasing value retail will improve the diversity of this revenue stream.
    - Unfortunately, the cost of real estate will likely impede the ability to increase value retail. Value retail is able to offer goods at budget prices due to volume sales. To achieve volume sales, the retail establishment must have significant square footage. Acquiring that in an expensive real estate market is prohibitive.
    - Consequently, revenue sharing with regional municipalities who have conditions conducive to value retail in exchange for sharing revenue from retail categories that are healthy in Boulder may be a sufficient off-set.

Nexus Funding

22. We remain committed to policy number 8. However, if earmarking occurs the following should be considered.
    - The BRC recognizes that asking voters for increased taxes or fees is difficult when a specific expenditure is not identified. In this type of election, the voter cannot determine if they will see an improvement in aspects of government they value.
    - The BRC suggests one way to overcome this dichotomy is to identify a minimum bundle of expenditures associated with the revenue increase, yet disclose that this revenue source will generate in excess of that expenditure which in turn will be used to maintain existing services.
    - In addition, the earmarking of all or a portion of the revenues should be sunsetted as soon as possible.

23. Earmarking of revenues if a fee must have a nexus to the expenditure (such as a transportation maintenance fee for transportation).
    - When earmarking is necessary, every attempt should be made to identify a clear nexus, or benefit to those who are paying the tax or fee.
24. Earmarked revenue sources must be able to participate in rebate programs.
    - BRC's study of the financial system revealed that earmarked revenue sources often do not participate in rebate programs offered by the city.
    - For example, the city collects a 3.41 percent sales or use tax. The city offers to rebate this tax for an economic vitality or charitable reason. Earmarked sales taxes such as Transportation, Parks and Recreation, or Open Space and Mountain Parks (OSMP) are not permitted to rebate the amount because the expenditure is not permitted in accordance with its enabling ordinance or tax passed by the voters. Therefore, the General Fund must pay the full rebate creating a disproportionate burden.
    - This leads to an imbalance in the financial health of the various funds.

Legislative Agenda

25. Monitor changes to TABOR and Gallagher amendments for negative impacts to the local revenue structure.
26. Oppose state increases to sales tax or property taxes (or other traditional local revenue taxes) without sharing income tax locally.
    - As the state grapples with its own revenue issues, there will be greater pressure to tap revenue tools traditionally the domain of local governments.
    - Recognizing there is an overall maximum tax burden that can be absorbed by the populace, such utilization of traditional local revenue sources by the state will diminish the city's ability to address new or changing financial needs.
27. Repeal the constitutional prohibition on Real Estate Transfer Taxes (RETT).
28. Repeal prohibition of collecting sales tax on Internet transactions.
29. Modify gasoline tax to be a percentage rather than flat rate.
    - The gasoline tax is collected at the state level and redistributed to local governments through the Highway Users Tax Fund (HUTF).
    - The gasoline tax is a fixed amount regardless of the price per gallon.
    - As the price per gallon of gasoline increases, the amount of gasoline sold often decreases.
    - Because the rate is fixed, the amount of revenue generated by this tax decreases. In order to maintain the transportation infrastructure that has already been purchased based upon current or previous utilization, the decrease in revenue negatively impacts ability to pay for infrastructure associated with transportation.
30. Pass enabling legislation for admission tax on state college events.
    - This is significant revenue potential for the city of Boulder.
    - The University of Colorado is not required to collect the Boulder admission tax on its events. This presents an equity issue as patrons to

these events utilize Boulder infrastructure to get to and from the event incurring an expenditure impact that all Boulder taxpayers must cover.

- Furthermore, this tax is a pass through from the patrons and does not result in diminished revenue for the university (assuming the admission tax has no effect on the price elasticity of the ticket).

31. Pass enabling legislation for a local income tax.
    - A pure income tax would provide greater flexibility in addressing equity, regressivity, and collection issues.

This collection of policies is both specific and broad. The implementation of many of these will likely require further policy and administrative discussion among those respective branches of the city government. When in place, the BRC believes this will create an environment that is most conducive to a stable and productive revenue structure.

TAXES and FEES

Appendix G outlines approximately 70 different revenue options the Blue Ribbon Commission explored for the purposes of solving this problem. While many tools were feasible, the BRC developed a set of criteria to determine which taxes and fees were most appropriate for this situation. Those criteria included the following:

- *Stabilization* – would this revenue source contribute towards improving the stabilization of the city's revenue system?
- *Gap* – Would the revenue source contribute towards eliminating the gap associated with the expanded General Fund?
- *Who Pays* – Who bears the burden of this tax or fee?
- *Revenue Potential* – The scale of this problem is significant. Will the revenue generated by the possible tax or fee generate an amount necessary to make a noticeable impact on the problem?
- *Issues and Equity* – The BRC was challenged to think beyond traditional revenue sources. Consequently, there were cases in which the revenue proposal was not legal, administratively impossible or totally inequitable. This category was designed to ask, can the issues be overcome?

Before reviewing the list, two important items need to be noted. First, the magnitude of this problem is unlike any Boulder has faced. If the city was to address the $135 million problem with a sales tax increase, it would require an increase of 1.7% in the rate (in addition to renewing the existing expanded General Fund sales taxes). That's a 50 percent increase by 2030.

Second, these listed revenue tools do not take into consideration additional tools that could be considered after further analysis and discussion. For example, sales taxes on services; Open Space Mountain Parks (OSMP) sales tax capacity; regional revenue sharing, special districts, and market based sponsorships. A brief summary of each of these follows.

Expanding the sales tax base to include some services

As discussed in Chapter 1, sales tax is currently assessed on durable goods. Durable goods are a smaller percentage of personal consumption and have a relatively flat inflation rate. This diminishes the productivity of the sales tax. Conversely, services represent approximately 60 percent of personal income and have an inflation rate greater than four percent. Sales tax on services is also currently permitted by law. The principle reason for not imposing such a fee is that services, and the vendors who provide them, are generally pretty mobile. If Boulder unilaterally imposed a service tax on accounting services, CPA's could easily relocate their office to Louisville and continue to provide the service to Boulder patrons.

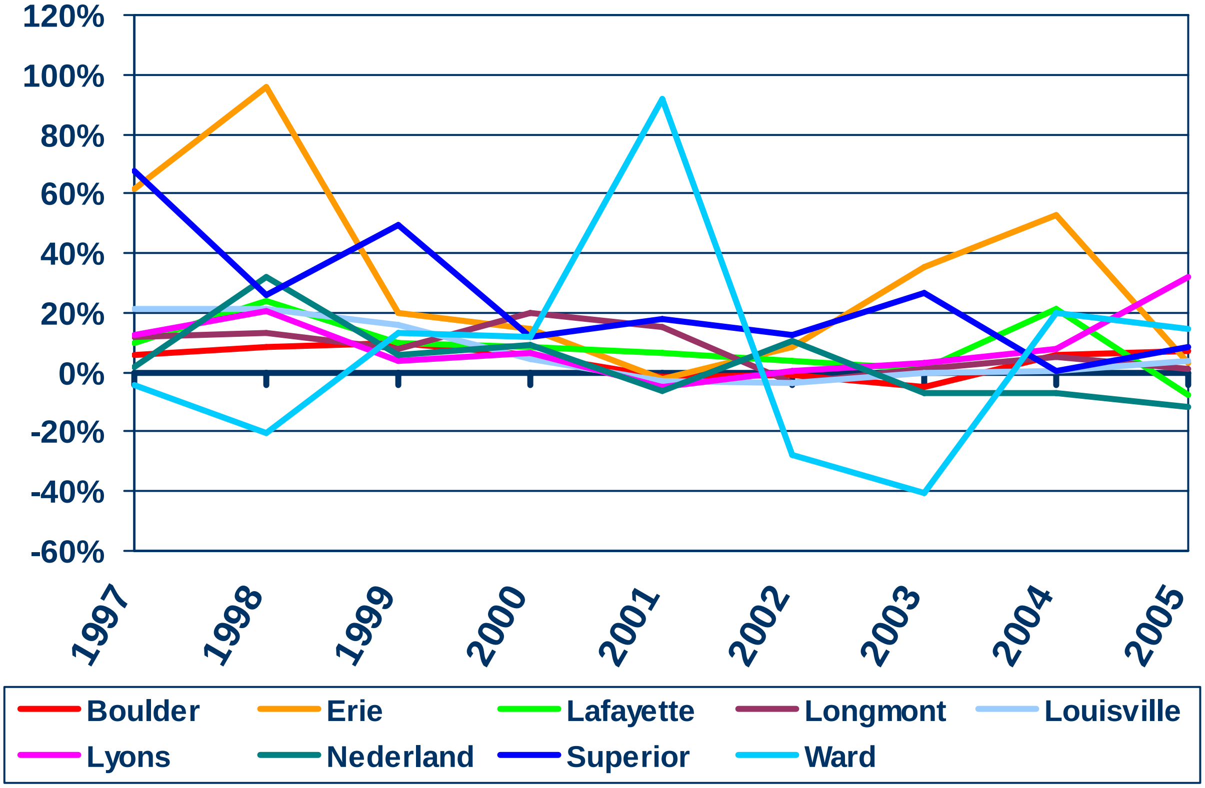
However, there are services that have less mobility or that entail small transaction amounts or sensitivity to a convenience factor. These include landscape services that are performed at a Boulder location. They also might include dry cleaning service or a barber shop. The BRC suggest that this complex and controversial issue be further analyzed, perhaps at a more regional level.

Expiring Open Space Sales Taxes in 2018 and 2019

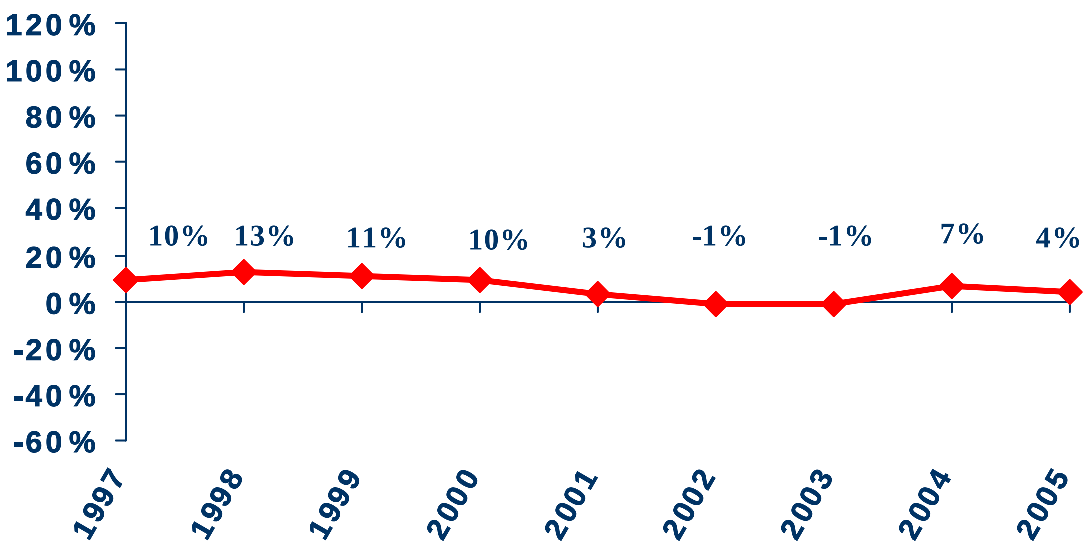
Another important revenue tool that is not immediately considered in the solution recommendations are the two sales tax increments dedicated to OSMP. The first is 0.33 percent and is due to expire Dec. 31, 2018. The second is 0.15 percent and set to expire Dec. 31, 2019. If these two sales taxes were combined, renewed and dedicated to the General Fund, they would generate $12.3 million in 2008 dollars. This tax capacity is extremely significant and the BRC noted its importance to the financial health of the city in the outlying years of this study.

Regional Revenue Sharing
Another important non-traditional revenue source with considerable potential is regional revenue sharing of sales tax. The city of Boulder continues to be a participant in the Boulder County Consortium of Cities' Revenue Stability initiative. This group is exploring revenue sharing models that would stabilize some of the cyclical effects of sales tax revenues by sharing them across the region. When examining the sales tax growth and decline across Boulder County (in the chart below), we see opposite peaks and valleys between cities.

Percent Change In Sales Tax & Use Tax Collection By City



Percent Change In Sales Tax & Use Tax Collection as a Region



As sales tax from Boulder's Crossroads Mall was declining and eventually completely eliminated, Broomfield's Flatiron's Mall was rising. As sales tax revenue associated with Louisville's Home Depot is tapering off, Boulder's Home Depot is growing. This pattern can be seen in other areas and speaks to the regional nature of retail sales. Consumers are fully willing and capable of driving to get the products they want at the price they desire. This has land use implications as well as competitive undertones that can diminish the overall productivity of sales tax (see Chapter 1 for a more detailed analysis). The BRC recommends continued participation in this endeavor with an emphasis upon diversifying revenues based upon retail type, such as value retail.

Special Districts

A revenue tool set aside by the BRC for addressing the gap was the use of special districts. Special districts are commonly used in Colorado for Libraries, Parks and Recreation, and Fire Departments. These districts primarily rely upon property taxes and therefore have potential for revenue diversification and long term growth. However, there are significant control issues associated with districts that were outside the scope of the BRC. Control issues refer to the fact that special districts are not governed by the City Council and therefore may be less responsive or create additional bureaucracies for Boulder residents. Given the regional nature of library services and the subsidization of unincorporated residents by municipal residents, this may be a candidate for special district consideration in the future.

Market Based Sponsorships

The last viable revenue tool not considered in the immediate package of revenue recommendations is the use of market based sponsorship. Market based sponsorships are best described through examples. This is the naming rights on public facilities. It is the selling of signage on bus stops and park benches. These had very little appeal to the BRC and would require significant policy changes by the City Council. Consequently, it was maintained in the inventory, but not used in the package of solutions.

In terms of the taxes and fees that were seriously considered by the BRC, here is a brief overview:

De-Brucing

As described in Chapter 1, the Taxpayer's Bill of Rights (TABOR) is a Colorado Constitutional Amendment that was passed in 1992. This amendment limits revenue growth to CPI plus new growth. Boulder voters have removed that limitation on the sales tax and 2 mills of the nearly twelve mills before the credit in property tax. As a result, a mill levy credit is calculated each year and for the 2007 tax year, the credit is equal to 23% of the total tax rate. As also noted earlier in this document, housing prices have been rising an average of 6% per year for the last 20 years. However, revenue from property taxes has lagged that trend due to the revenue limitations imposed by TABOR.

The commission felt this was the most viable revenue tool to reduce the gap due to its revenue potential and proven political acceptability in Boulder and other governmental jurisdictions. A fully de-Bruced property tax would generate $6.7 million in 2008. Because this would increase property taxes paid to the city by approximately 30% when fully implemented, the BRC suggested a phased approach in which one-quarter of the tax is de-Bruced every two years. The phased-in approach also aligns with the "stair step" approach necessary to close the gap as described earlier in this document As an example, a complete De-Brucing of city property taxes would require a residential property owner with a house valued at $500,000 to pay an additional $111 per year.

Development Excise Tax (DET)

The Development Excise Tax (DET) was another highly viable tax or fee. This is a revenue tool designed to recover the cost of growth associated with new residential and commercial development. The philosophy is that a new residential owner receives the benefit of existing streets, utility infrastructure, parks and schools that previous tax payers paid to create. Moreover, much of the infrastructure was oversized to handle some future growth. Therefore, it is necessary for the new development to pay its share of this infrastructure. In order to accomplish this, a development excise tax is imposed. This is also referred in many communities as an impact fee or, as in the City of Fort Collins, Colorado as an Adequate Facilities Charge. Regardless of the term, the mechanism is designed to facilitate growth paying its own way.

Based upon a study done in 1998, the DET was significantly below the full cost recovery of new growth. The Blue Ribbon Commission recommends an immediate commissioning of a new study to determine the full cost of recovery and/or a study of comparable fees in adjacent municipalities. The BRC also recommends consideration of assessing the DET against residential expansions, which are currently exempted. While this revenue tool can be imposed as a fee and therefore adopted by ordinance, Boulder has historically adopted these fees as a tax with voter approval. This provides the greatest resistance to legal challenges, but it may compete with other tax initiatives designed to eliminate the gap that are on the same ballot.

New Sales & Use Taxes

The sales and use tax is a very popular revenue tool because it generates substantial sums of money at a very low rate. For the city of Boulder, a 0.10% sales tax (a penny on a $10 purchase) generates 2.5 million dollars each year. The majority of that revenue comes from non-residents and employers. It also has a well established administrative system for collection and audits. Lastly, there is some discretion associated with the sales tax. In other words, a person can choose not to buy the product and avoid the charge. Therefore, despite its decreasing productivity over the planning horizon, this revenue tool is kept in the mix as a potential tool.

New Property Tax

The property tax is commonly considered to be widely disliked by citizens. This revenue source, however, is extremely stable and for Boulder has the greatest potential to grow at a rate comparable or greater than expenditure inflation. Moreover, property taxes in Colorado are not heavily relied upon by local governments and are therefore considerably lower than their out-of-state comparables. For those moving to Boulder from out-of-state, this lower rate is often remarked upon. The BRC sees that as available tax capacity. Conversely, the property tax is heavily relied upon by counties and school districts as their principle form of revenue. Therefore, increased property tax rates by cities diminish tax capacity these other entities may need and cannot find in other revenue tools. For the city of Boulder, a one mill increase that is De-Bruced will currently generate approximately $2.4 million dollars in revenue and would require a residential property owner with a house valued at $500,000 to pay an extra $40 a year.

Occupational Privilege Tax (a.k.a. Head Tax)

Municipalities in Colorado are not permitted to collect an income tax. That right is reserved for the state. However, cities may impose an occupational privilege tax (OPT). This is also known as a head tax because of the way it is imposed. Specifically, the OPT, in its pure form, imposes a flat dollar amount on each and every employee working in the municipality. In addition, the employer must pay an equivalent tax per each employee they employ. For example, if an employer had a hundred employees and the OPT was $2 per month, the employer would need to deduct from each employee $2 per month and match it with $2 for each employee, for a total of $400 each month. In other words, it is a tax per head rather than a percent of income.

The OPT is in place in Aurora, Denver, Glendale, Sheridan and Greenwood Village. While the tax cannot vary based upon income level (in other words, the tax is $5 for those making less than $100,000 and $5 for those making more than $100,000), a minimum income threshold can be imposed upon which no one making less than that amount can be charged the tax. For the City of Denver, that amount is $500 per month. For Greenwood Village that amount is $250/month.

Previous examinations of this tax in Boulder have identified three significant concerns: 1) it places Boulder businesses at a competitive disadvantage to those in the region; 2) governments do not have to pay the employer portion and Boulder has a significant government employment base; and 3) the impact on non-profits. Consequently, the BRC considered this proposal assuming only employees pay the tax and not employers. In this scenario, Boulder businesses would not have to pay it, but simply collect it from their employees.

This revenue source is anticipated to generate approximately $1 million for every $1 OPT per employee per month. This is a very steady revenue stream and is based upon the number of employees working within the city. The fluctuations in job growth have some volatility, but not as much as typically experienced with sales taxes.

Accommodation Tax

This is a tax assessed upon overnight stays in Boulder. It is often referred to as a hotel/motel tax as that is the most common place it is assessed. For each one percent increase in the accommodation tax, a corresponding $500,000 is projected to be generated.

This tax has been partially (9% of the total revenues received) redirected to the Boulder Convention and Visitors Bureau to help perpetuate tourism in Boulder. While the city does not gain the entire accommodation tax, full hotels mean visitors in town spending money on sales tax eligible goods. This is also why this tax is considered a good candidate for funding a community conference center.

Real Estate Transfer Tax (RETT)

This is a tax imposed upon the sale of real estate. Think of it as a sales tax. With the adoption of TABOR in 1992, new RETT's were prohibited by constitutional amendment. Therefore, those who had this tax in place could continue to impose it, but no other jurisdiction could add it even if the voters of that community approved. This is a particularly common tax in many Colorado ski towns. Real estate is commonly bought and sold in the second home market prevalent in these communities. Moreover, the value of these homes is quite high. Therefore, this is a very productive revenue tool.

Due to its constitutional prohibition, the BRC did not endeavor to determine the revenue potential of this tool. However, because the tax is associated with real estate and residential real estate values in Boulder have been growing an average of 6% per year over the past twenty years, it is a prime candidate for a structural solution. Moreover, there is support for going to the Colorado voters to repeal this prohibition among many Colorado mountain towns who did not have a RETT in place prior to 1992. Therefore, BRC recommends this issue be placed on the city's legislative agenda for exploring and building coalitions.

Food Tax Differential

The Boulder sales tax is 3.41% in 2008. However, the Boulder sales tax rate on prepared food—that is, food at restaurants—is 3.56% or another 0.15% higher. During its work on this project, the BRC learned that the city and county of Denver has a prepared food sales tax rate of 4.00%. This is 0.44% higher than the city of Boulder. While consumption of prepared food is fairly volatile, the tax upon it is fairly inelastic and paid by a substantial number of non-residents. The BRC therefore noted this revenue tool, although small, as a good candidate for consideration, although it has been discussed as a possible source of revenue for a conference center.

Transportation Maintenance Fee

This is a fee similar to a storm drainage utility fee. It is established to maintain city streets, bike lanes, medians and sidewalks. Maintenance functions include repaving, pothole repair, seal coating among others. The fee could be assessed based upon land use type and size. The BRC suggests that it be a flat rate for residential, and based on traffic generation for commercial/industrial properties. A summary of how the fee works and the corresponding rates used for these purposes can be found in Appendix K. It is a fee and therefore adopted by ordinance, however, it could be adopted as a tax by the voters. Moreover, it would likely be assessed on the utility bill. The city of Fort Collins considered this fee several years ago. It was legally challenged. The issue went to the Colorado Supreme Court and was found to be a valid revenue tool for Colorado municipalities. Since then, the city of Loveland has implemented such a fee but the city of Fort Collins has not. Using the rates considered by Fort Collins, this fee would raise approximately $2.3 million a year in 2007 dollars.

Parks Maintenance Fee

Similar to the Transportation Maintenance Fee, it is a fee that could be assessed on utility bills to pay for the maintenance of existing parks. Unlike the transportation maintenance fee, this fee would only be assessed upon residential properties due to the nexus between park use and residency. Based upon rates considered by Fort Collins, this revenue tool would generate approximately $900,000 a year. A full description of the fee can be found in Appendix K.

Increase the Number of Sales Tax Auditors

One revenue tool that received consideration by the BRC was increasing the number of sales tax auditors. The philosophy is that before asking for new money, collect the dollars that are already authorized. In the city of Boulder, each auditor has historically generated approximately $300,000 in revenue. As a result of this discussion, the Finance department requested an additional sales tax auditor in the FY 2008 budget and it was awarded. The increased revenue was used to offset erosion caused by inflation that is associated with existing expenditures.

Below is a table listing those taxes or fees that were seriously considered by the BRC with a projected amount each would generate in 2008 dollars:

Revenue Option	Unit	$ Generated/yr	$ in 2008
De-Bruce Remaining Property Tax	2.78 mills	$6.7M	$6.7M
Development Excise Tax (DET)	at 1998 Tischler Rec Rates =		$3 - 6M
Sales and Use Tax	0.10%	$2.5M	N/A
Property Tax	1 mill	$2.4M	N/A
Occupational Privilege Tax (Head Tax)	1$/ee/mo and $1/er/mo	$1.6M	@ $5 = $8.0 M
Accommodation Tax	1%	$500K	N/A
Real Estate Transfer Tax	1%	$7.5M	N/A
Increase food sales tax differential rate	1%	$2.7M	@ 0.44 = $1.4M
Transportation Maintenance Fee	residential unit & commercial trip generation	@ Ft Collins rate =	$2.3 M
Parks Maintenance Fee	residential unit	@ Ft Collins rate =	$900,000
Increase number of Auditors	1 FTE	$300,000	N/A

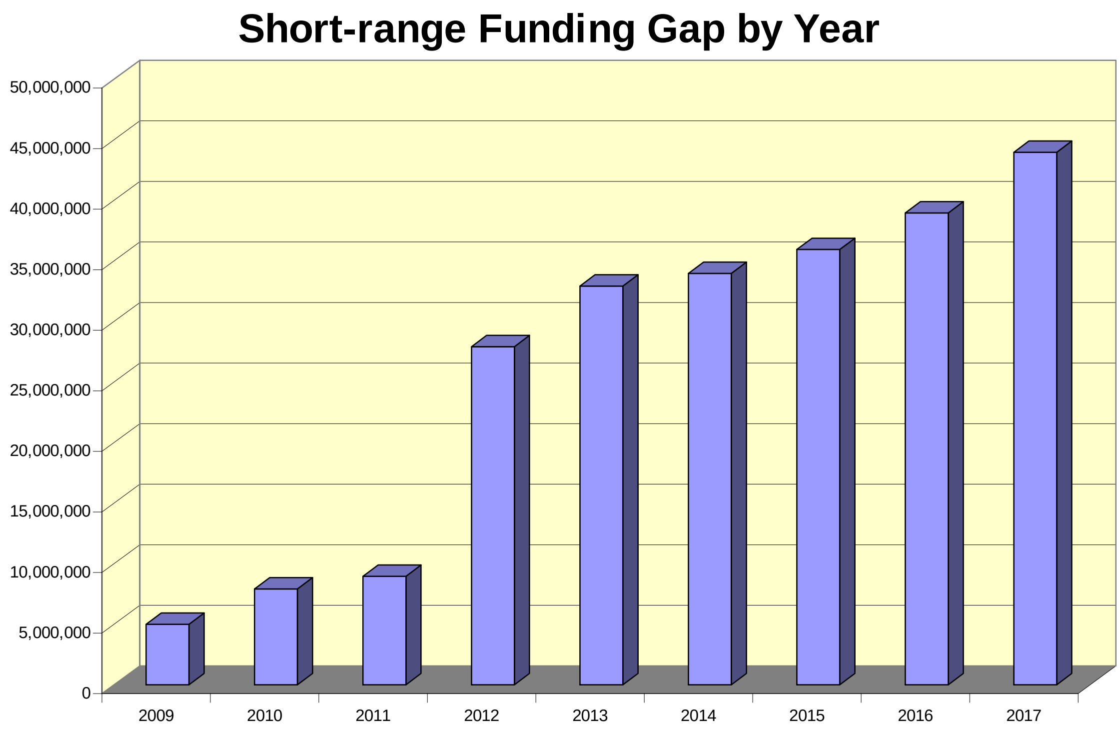
In summary, these policies, taxes and fees were identified by the BRC as having the greatest potential for eliminating the gap, increasing revenue stabilization, and perhaps achieving programs and services recommended in various departmental master plans. How they are packaged to accomplish these financial challenges is set forth in Chapter 4.

4 REVENUE SCENARIOS

The Blue Ribbon Commission (BRC) presented its findings that outlined the long-term financial problem to the City Council on April 10, 2007 (see Chapter 1). Subsequent to that meeting, the commission focused upon developing solutions to sustain the financial future of the city of Boulder (Chapter 2). These numerous meetings explored various revenue tools that were then developed into the most plausible and sufficient instruments (Chapter 3).

When the selected revenue tools were applied to eliminating *the gap* predicted for 2030, plus funding essential and desirable items associated with various departmental master plans, the scale of tax and fee increases was overwhelming and politically infeasible. Consequently, the BRC reduced the solution time horizon to 2017 in order to address the most pressing sales tax renewals and tackle some structural diversity issues. The BRC recognizes a 2017 time horizon is half of what was charged to the commission. However, the packages of sample scenarios set forth in this chapter, plus the ever changing economic and political environment of public finance, necessitate regular monitoring of the situation. In short, the BRC believes that **this document should serve as the foundation of an ongoing comprehensive financial plan**. It is similar to, and perhaps could be incorporated into the Boulder Valley Comprehensive Plan (BVCP). It could be a comprehensive financial plan that would provide a long-range revenue and expenditure forecast, an examination of the productivity and appropriateness of various revenue tools, and a matching of anticipated expenditures against revenues that are available or requires generation. In that sense, the BRC puts forth the following options.

First, generating sufficient revenue to eliminate the gap was identified as the first priority of the BRC recommendations due to its focus on providing essential services that the Boulder community already relies upon. For shorthand classification, the series of recommendations to eliminate the gap over the next ten years is characterized as the <u>Basic Package</u>. An important element of the gap is recognizing its annual growth. In other words, the expanded General Fund (GF) gap in 2030 is $135 million, but how much is it each year? Knowing this dictates the timing associated with the various options presented. The graph below identifies the gap amounts for each year between 2009 and 2017.



The reader will note that the growth is not linear. This is due to the expiring sales taxes over this planning period. **Of absolute essence to the financial feasibility of closing the gap is the renewal of three existing sales taxes**: the 0.38 percent which expires in 2011, the 0.15 percent sales tax that expires in 2012; and the 0.25 percent sales tax that expires in 2015. All of these sales taxes must be renewed and consideration should be given to not earmarking the renewed taxes. Programs and services not in the General Fund which currently rely upon these sales taxes will continue to require a transfer to their appropriate account. However, putting all money from these sources in the General Fund will provide the greatest degree of flexibility to address priorities on a citywide basis.

Again referring to the BRC charge, the commission offers a more general Enhanced Package meant to **"**accomplish public priorities while allowing flexibility to meet the varied and dynamic needs of the municipal corporation in the next 20 years." The enhanced package looks at funding essential and desirable programs and services found within the Action Plans of the following Strategic or Master Plans (see Appendix F for an explanation of Business Plan terminology):

- Municipal Court
- Economic Vitality
- Facility and Asset Management (FAM)
- Fire
- Housing and Human Services (HHS)
- Library
- Parks and Recreation (P&R)
- Planning and Development Services (P&DS)
- Police
- Transportation

For a more detailed listing of what programs and services are incorporated in the Enhanced Package, see the corresponding section that begins on page 52.

BASE PACKAGE

Goal: Provision of the same bundle of services, plus the identified critical deficiencies (described below), plus an increment for growth in population and employment, at the same service standard in 2017 as was provided in FY 2008 with less volatility in the revenue stream. This package is synonymous with eliminating the 2017 gap.

Anticipated Gap in year 2017: For the expanded General Fund (see Appendix J)

- $44,000,000 assuming the expiration of the .38 and .15 GF Tax, and .25 P&R
- $18,000,000 assuming the .38, .15 and .25 are renewed

Highlighted Gap Expenditures: The base package is focused upon accomplishing revenue diversity and curing the erosion that occurs when revenues grow at three percent per year but expenditures grow at four percent per year. Most of the reason that expenditures increase at four percent is due to the inflation of municipal inputs (personnel, energy, asphalt and cement), but there are also some increases due to population and job growth accounted for in the gap. In order to provide the same bundle of services in 2017 as was provided in 2008 at the same service standard, the ratio of certain services to levels of population/use needs to be maintained (for example, maintaining the number of police officers per 1,000 people).

Funding the gap also provides revenue for four Identified Critical Deficiencies (ICD) without changing the overall service standard. In other words, there are capital or core operational items in place in FY2008, but no funding mechanism to replace them as they wear out and need to be replaced. The ICDs are:

- Develop a fire apparatus replacement mechanism to replace the vehicles that are currently in the stations when their useful life expires;
- Develop a software replacement mechanism to replace software that is currently in use to operate the city when the software exceeds its life expectancy and/or the vendor no longer supports it (ex: financial software, human resources software, police records software);
- Increase FAM (Facility and Asset Management) fees to fund 50 year replacement and ongoing maintenance of most existing facilities (see the 2005 FAM Master Plan for additional detail); and,
- Increase funding to match the inflation costs associated with energy and fuel.

Recommended Policies: The commission recommends a series of policies that embrace best practices, principles of a stable revenue stream, and identified efficiencies that should reduce the gap. Those policies are listed with brief explanations in Chapter 3. The BRC finds these policies a compliment to the revenue tools identified and essential to a successful long term solution to these financial challenges. Recognizing that the BRC did not have the time, nor the knowledge to understand all the intricacies and challenges associated with implementing these policies, the BRC still believes that the adoption will reduce the gap. Consequently, the BRC recommends under funding the basic package by $1 million as an incentive to accomplish these recommendations**.** To make the transition of these policies from paper to practice, the BRC encourages council and staff to set to work immediately tackling policy implementation.

Revenue Tool Options**:** The Blue Ribbon Commission presents three revenue tool sample scenarios for council's consideration in addressing the gap. These options identify each revenue tool recommended (an explanation of the tool can be found in Chapter 3), the year it is recommended to take effect (so as to correlate with the anticipated gap at that time), and the amount it is anticipated to generate in the year 2017 (the recommended planning horizon). Renewal of the three sales taxes (General Fund .38 and .15 along with the Parks and Recreation .25) is the highest recommended revenue tool action of the BRC. For this reason, these three revenue tools are found in each of the options presented and account for 60 percent of the revenue generated. These taxes cannot be taken for granted. However, because they are already in place, little analysis was afforded to them in these options.

In order for council and the public to properly analyze each sample scenario, the BRC has provided a pro-con subsection, a burden analysis and a diversification analysis. The burden analysis subsection examines who would be impacted by the recommended taxes or fees. The burden analysis for each scenario has been completed to indicate who will bear what portion of the incremental burden from any new tax, fee or other type of revenue that may be considered.[4] Some of the revenues are fairly straight forward while others required making reasonable assumptions. This analysis segregates the burden into three categories of taxpayers: residents, visitors (includes non-resident sales taxpayers and non-resident employees) and employers. The diversity analysis speaks to the BRC charge to create a "balanced and stable revenue stream." Of principle concern will be the option's ability to reduce dependency on sales tax and implement revenue tools that have a better opportunity to inflate at the expenditure rate.

Lastly, the BRC is recommending the implementation of de-Brucing the full city of Boulder property tax and increasing the development excise tax (DET) by a small amount pending further study. Both of these revenue tools have been proven to be politically feasible in Boulder, capable of growing at four percent or greater each year, decrease dependence upon sales tax, and generate a meaningful amount to close the gap. Consequently, **in addition to renewal of the three aforementioned sales taxes, de-**

[4] While it may be helpful to have a burden analysis of the current revenues received by the expanded general fund, this is a very complex exercise and requires additional detailed analysis. Current revenues are not based on incremental revenue but on revenue structures that have evolved over the decades that the city has been in existence. There are well over one hundred individual lines items that would have to be analyzed and there was not time to complete an analysis of this size. Due to the number and types of revenues and the large amount of assumptions that would have to be made, it is questionable that the final product would be of the quality desired. In the end, it was determined this analysis was not essential for completing the Blue Ribbon Commission report.

Brucing the property tax and increasing the DET are highly recommended by the BRC.

Sample Scenario A

Sample Scenario A	Year Effective	2017 Amount/Yr
Renew GF .38 Sales Tax	2012	$13,000,000
Renew GF .15 Sales Tax	2013	$ 5,100,000
Renew P&R .25 Sales Tax	2016	$ 8,500,000
De-Bruce over 6 years	2009-2015	$ 9,300,000
Increase DET $500K	2009	$ 600,000
Increase Sales Tax .10	2010	$ 3,400,000
Institute Trans Maint Fee	2009	$ 2,900,000
Institute Park Maint Fee	2009	$ 1,100,000
Total New		**$43,900,000**
Total Minus Renewals		**$17,300,000**

Pros and Cons

Pros

- 52 percent of sales tax paid by non-residents or employers;
- De-Brucing may be more politically acceptable than other taxes since Boulderites have de-Bruced some of the property tax already and supported de-Brucing the county's property tax, and phased in to reduce impact;
- Increase dependency on property tax which has greatest potential to grow at four percent per year;
- DET revenue currently under market and full cost recovery rates; and
- Fees proven legally valid.

Cons

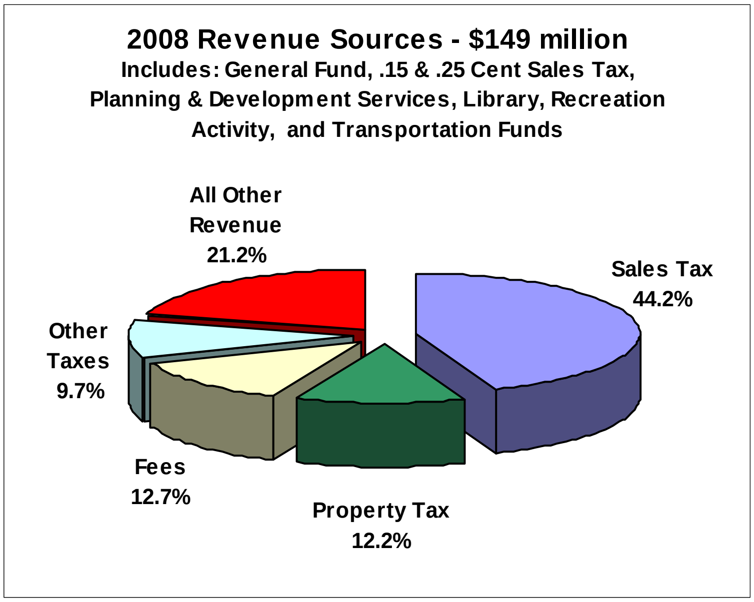
- Could require eight ballot questions to implement; that number could be reduced to five if council implements DET as a fee, transportation maintenance and park maintenance fees by ordinance rather than by election;
- Increases the sales tax rate; and
- Asks for park maintenance fee on top of P&R sales tax renewal.

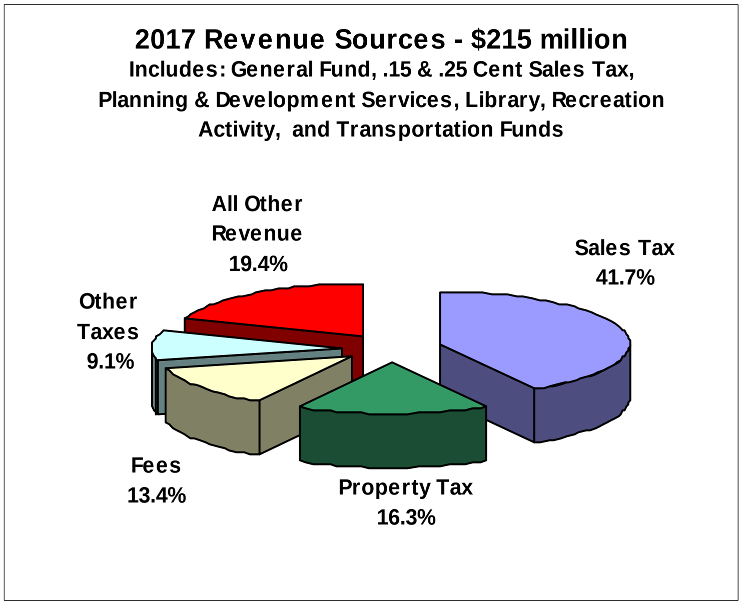
Burden Analysis

Not counting the renewals, 20 percent of this sample scenario continues to rely upon sales tax. The proposed sales tax increases generate about $3.4 million and would likely continue the 48/25/27 split among residents/visitors/employers in payment. The other 80 percent of the revenue generated by this proposal would be associated with de-Brucing, increasing the DET, and imposing transportation maintenance and parks maintenance fees which fall on property owners in some form or fashion. De-Brucing property tax would result in approximately a 30 percent increase in city property tax revenues. In addition, property tax is a more stable revenue source than sales taxes and is projected to grow 4% each year.

The maintenance fees generate the equivalent of 1.66 mills if they were property tax. Property tax burden is split 45 percent residential and 55 percent businesses in accordance with the Gallagher amendment. The DET is assessed on new development, of which 80 percent is historically associated with residential development. So while the DET burden would fall on residents and employers, it would be self-imposed as the property owner chooses development. In summary, the burden of the new revenue would breakdown as follows: 51 percent resident; 5 percent visitor; and 44 percent employer.

Revenue Diversity





These pie charts illustrate the revenue diversity of the 2008 revenue system versus the diversity of the revenue system in the year 2017 under Sample Scenario A. This would decrease reliance on sales tax somewhat and shift that dependence towards property taxes and fees. Both of these latter revenue tools are more likely to grow at an inflation rate similar to expenditures. Of the three options, this one has the greatest continued reliance on sales tax.

Sample Scenario B

Takes Sample Scenario A and trades the new sales tax for a one mill increase in the property tax; increases DET such that at least $1 million more is generated in 2009; imposes an increase in the sales tax differential on prepared food, deletes maintenance fees, and increases the accommodation tax with the assumption that all new dollars go to the General Fund.

Sample Scenario B	Year Effective	2017 Amount/Yr
Renew GF .38 Sales Tax	2012	$13,000,000
Renew GF .15 Sales Tax	2013	$5,100,000
Renew P&R .25 Sales Tax	2016	$8,500,000
De-Bruce over 6 years	2009-2015	$9,300,000
Increase DET ($1M)	2009	$1,200,000
Increased Prepared Food Diff .044	2009	$1,900,000
Increase Property Tax 1 mill	2010	$3,000,000
Increase Accommodations Tax (2.0%)	2011	$1,300,000
Total New		**$43,300,000**
Total Minus Renewals		**$16,700,000**

Pros and Cons

Pros

- Brings prepared food sales tax differential in line with Denver;
- Accommodation tax still below Colorado tourist towns;
- No transportation or parks fee;
- De-Brucing may be more politically acceptable than other taxes since Boulderites have de-Bruced some of the property tax already and supported de-Brucing the county's property tax, and could be phased in to reduce impact;
- Increase dependency on property tax which has greatest potential to grow at four percent per year; and
- DET revenue under market and full cost recovery.

Cons

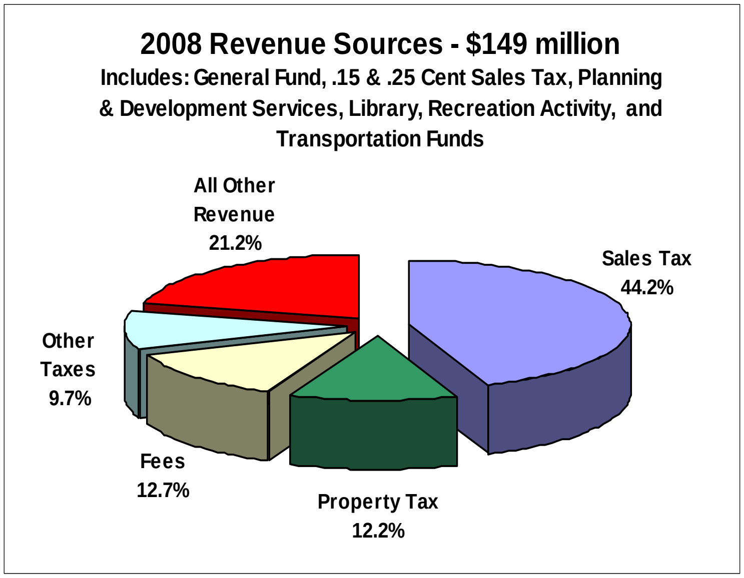
- Would require eight ballot questions to implement; that number could be reduced to seven if council implements DET fee by ordinance rather than by election;
- Increases dependency upon volatile sales (prepared food) and accommodation tax;
- Increased accommodation tax not shared with Boulder Convention and Visitors Bureau (BCVB); this tax was also eyed as a revenue source for the conference center;
- Property tax one of most disliked taxes and competes with county and school district; and
- Food differential a candidate for Conference Center funding.

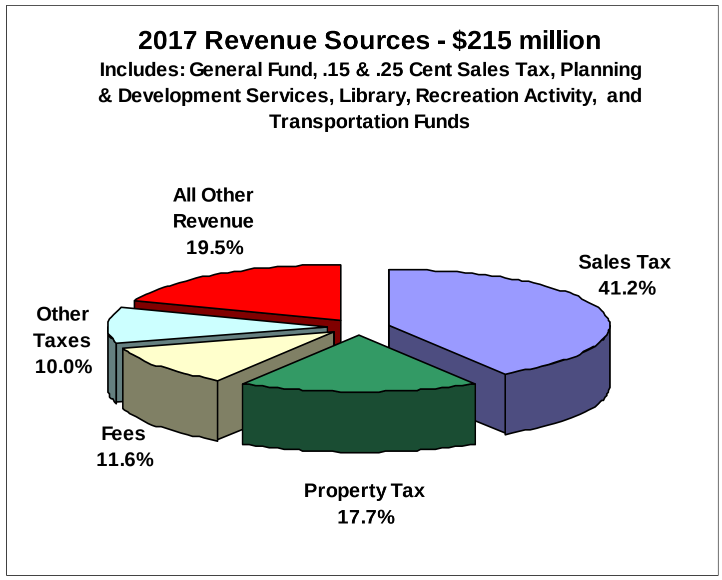
Burden Analysis

De-Brucing property tax would result in approximately a 30 percent increase in city property tax revenues. In addition, property tax is a more stable revenue source than sales taxes and is projected to grow 4% each year.

This option also calls for a one mill increase in the property tax. Again, it is assumed that the property tax burden is split 45 percent on residential and 55 percent on employers. This proposal also includes a meaningful bump in the DET that would be borne by property owners who develop their property. The other two revenue tools (sales tax differential on prepared food and accommodation tax dedicated to the General Fund) would fall mostly on visitors. In summary, the revenue burden would break down as follows: 44 percent resident; 11 percent visitor; and 45 percent employer.

<u>Revenue Diversity</u>





These pie charts illustrate the revenue diversity of the 2008 revenue system versus the diversity of the revenue system in the year 2017 with Sample Scenario B. Sample Scenario B would decrease reliance on sales tax somewhat and shift that reliance almost entirely towards property tax. While this has great potential to keep pace with the inflation rate of expenditures, it also results in the burden being borne more by residents and employers.

Sample Scenario C

Transfer as much burden to visitors and new residents as possible while maintaining the de-Brucing revenue tool.

Sample Scenario C	Year Effective	2017 Amount/Yr
Renew GF .38 Sales Tax	2012	$13,000,000
Renew GF .15 Sales Tax	2013	$5,100,000
Renew P&R .25 Sales Tax	2016	$8,500,000
De-Bruce over 6 years	2009-2015	$9,300,000
Increase DET ($500K)	2009	$600,000
Increased Prepared Food Diff .044	2009	$1,900,000
Increase Accommodations Tax (2.0%)	2014	$1,300,000
Head Tax $4 Total	2010	$4,000,000
Total New		**$43,700,000**
Total Minus Renewals		**$17,100,000**

Pros and Cons

Pros

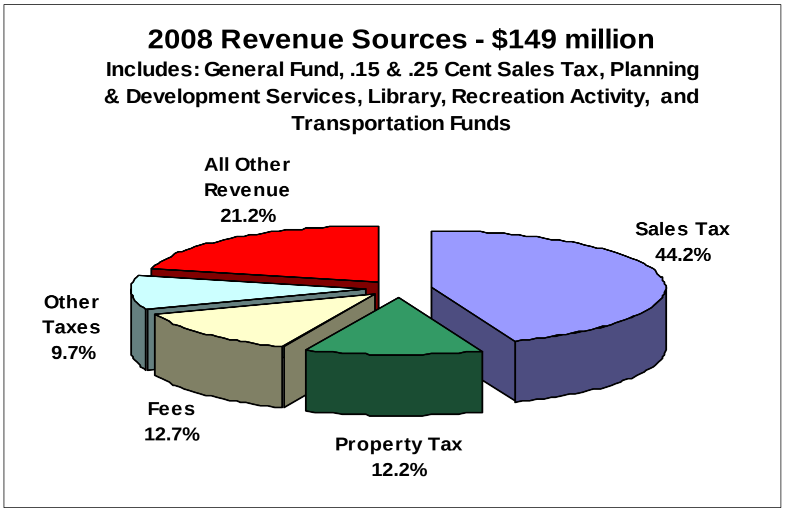
- Brings prepared food sales tax differential in line with Denver;
- Implements a head tax which is borne 50 percent by non-residents;
- Accommodation tax still below Colorado tourist towns;
- No transportation or parks fee;
- De-Brucing may be more politically acceptable than other taxes since Boulderites have de-Bruced some of the property already and supported de-Brucing the county's property tax, and it can be phased in to reduce the impact;
- Increased dependency on property tax which has greatest potential to grow at four percent per year; and
- DET revenue under market and full cost recovery.

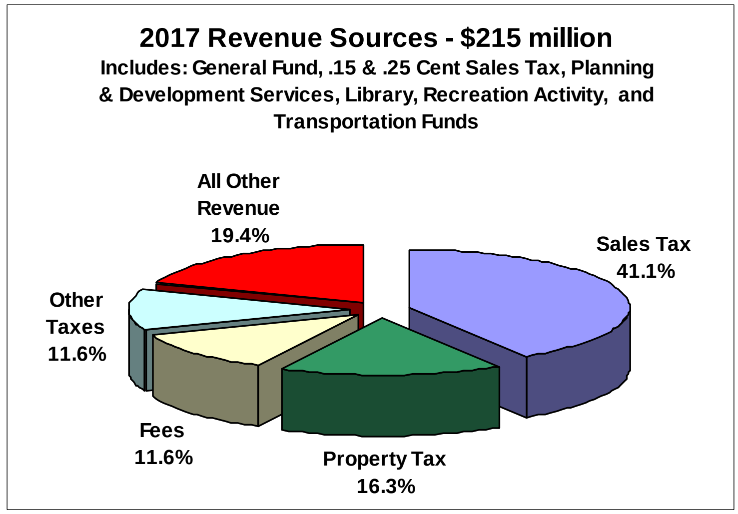
Cons

- Would require eight ballot questions to implement; that number could be reduced to seven if council implements DET fee by ordinance rather than by election;
- Increases dependency upon volatile sales (prepared food) and accommodation tax;
- Increased accommodation tax not shared with BCVB; was also eyed as a revenue source for the conference center;
- Food differential a candidate for Conference Center funding;
- Head tax creates a competitive disadvantage for Boulder employers since not imposed elsewhere in Boulder or Broomfield County; and
- 50 percent of head tax borne by in city residents.

Burden Analysis
This proposal takes Sample Scenario B and exchanges the increased mill levy for a head tax that would be completely borne by the employees. Boulder's employment base is approximately 50 percent residents and 50 percent non-residents. This shifts the burden accordingly and imposes no burden directly upon the employer with the exception of collection obligations. De-Brucing property tax would result in approximately a 30 percent increase in city property tax revenues. In addition, property tax is a more stable revenue source than sales taxes and is projected to grow 4% each year. The DET remains in the mix but at a lower level. While 80 percent of this tax is borne by residents, it is typically borne by new residents. In this instance, the burden is shared: 44 percent resident; 25 percent visitor; and 31 percent employer.

Revenue Diversity





These pie charts illustrate the revenue diversity of the 2008 revenue system versus the diversity of the revenue system in the year 2017 under Sample Scenario C This would decrease reliance on sales tax to the smallest portion of any option. That reliance would be transferred to property tax and the "Other Taxes" categories. While the property tax is likely to grow at a similar inflation rate to expenditures, the head tax will only grow based on the number of new jobs (according to the BCVP, jobs are anticipated to grow by approximately 1% annually for a total of 122,000 by 2030.) unless it is also adjusted annually by some factor such as the Consumer Price Index.

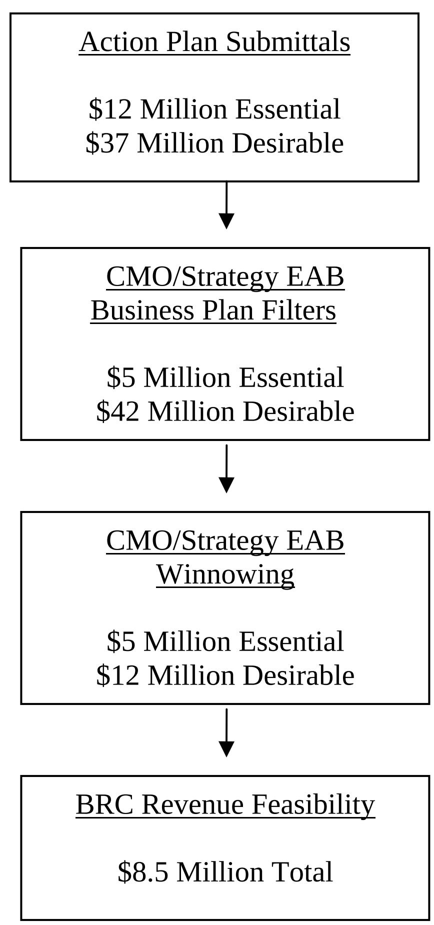
These three revenue tool scenarios are packages the BRC has created that address diversification, growth, timing and burden while eliminating the 2017 gap. The BRC anticipates that City Council will desire to mix and match the revenue tools in an effort to develop a package that eliminates the gap but meets other concerns or strategies. Therefore, the commission has outlined the most prominent tools in Chapter 3. However, it is probably prudent that any package drafted by council have a subsequent diversity, timing, growth and burden analysis conducted for comparison purposes.

ENHANCED PACKAGE

Part of the original purpose of the BRC was to identify revenue sources to help fund departmental master plans. These master plans provided a blueprint for enhancing city programs and services to improve the quality of life in Boulder. Although the discovery of a potentially large gap in funding basic services became a critical concern of the BRC, being able to provide enhanced city services as delineated in the master plans is also critical.

City departments were asked to resubmit their 2008 Budget Action Plans assuming a 10 year planning horizon. Those submittals identified $12 million annually in essential programs and services. Those same submittals identified $37 million a year in desired programs and services. Many of these requests were to increase the service standard of existing programs from below standard to standard.

The City Manager’s Office, in partnership with an Executive Advisory Board (made up of several department directors), prioritized these requests into $5 million per year in essential programs and services and $12 million per year in desired programs and services. A graphical representation of this “winnowing” process can be seen below with the resulting list found in Appendix H & I:



The BRC reviewed these requests and found many of them to be very important additions. Consequently, the commission suggests raising another $8.5 million (50% of the items shown in Appendix H & I) through the various revenue tools identified in Chapter 3. The $8.5 million will obviously not fund all of the programs listed and some additional prioritization will need to take place. Connecting programs or services in these lists to various revenue tools identified in the base package may assist in this prioritization and could improve the likelihood of adoption by the voters.

Funding the Enhanced Package

It should be noted that the 2017 and 2030 funding gaps do not include any funding to enhance city programs and services. The inclusion of the $8.5 million enhanced package (as shown in Appendices H & I) would increase the 2017 funding gap from $44 million to $56 million and the 2030 funding gap from $135 million to $155 million. The $8.5 million enhanced package would require a significant infusion of new ongoing revenue. For illustrative purposes, in addition to the revenue increases specified in Sample Scenarios A, B or C, funding the enhanced package would require:

- A new 0.35% sales tax or,
- A new 3.54 mills of property tax or,
- A new or additional Occupational Privilege Tax of $5.31 per month for both the employee and employer or,
- A combination of portions of the revenue mechanisms shown above plus increases in other taxes and fees (in particular DET since some of the enhanced needs are growth-related), along with potentially significant trade-offs of existing services/programs for newer ones.

THE 2030 PACKAGE

While a full analysis of revenue options for 2030 wouldn't be appropriate due to the considerable uncertainties inherent in such long-range forecasting, the BRC felt a broad overview should be presented to show the impact of eliminating the currently projected gap between 2017 and 2030. It is clear to the BRC that the anticipated $135 million funding gap in 2030 cannot be completely addressed solely through additional sales taxes (or any single revenue source). To close the projected 2030 gap, the Commission assumes that the short-range funding gap in 2017 has been resolved through implementation of a variety of revenue and policy strategies, and that these would continue through the 2017 to 2030 period and thus help reduce the long-range 2030 funding gap.

The BRC would also like to point out the potential of an additional revenue source associated with the current Open Space sales tax capacity. There are two sales taxes associated with the acquisition of Open Space that are set to expire at year-end 2018 and 2019. Open Space and Mountain Park's staff indicated that upon the expiration of these taxes, land acquisition will become secondary to operational concerns. This 0.48 percent sales tax capacity provides an opportunity to substantially eliminate a significant portion of the remaining gap beyond 2019. Therefore, the Commission suggests completing further analysis regarding pursuing re-authorization of the expiring Open Space sales taxes but redirecting them to the General Fund in order to decrease the long-range funding gap.

Assuming the 2017 gap in the base package of programs and services is resolved (and assuming permanent approval of ongoing revenues) would lower the $135 million funding gap in 2030 to $70 million. The potential re-authorization of expiring OSMP sales taxes as General Fund revenues would further decrease the 2030 funding gap to $48 million (in 2030 dollars).

Closing this remaining $48 million gap would require an additional 0.95% sales tax increase (if funded entirely through sales taxes). This would be on top of any sales taxes and other taxes/fees that are part of the continuing set of revenue tools used to close the 2017 gap. When added to the existing 3.41% sales tax, the 2030 rate would be at minimum 4.36%, and, assuming that no other taxing entity increases their rates, the total sales tax rate for goods purchased within the city of Boulder would be at least 9.11%.

However, it is important to note that this remaining $48 million gap only reflects funding for the base package of services at current levels of service. The BRC believes that it is unrealistic to plan to provide only current programs and services from now through 2030. To fund any additional programs and/or services, or improve current service levels, will require additional new revenues and/or very significant trade-offs, as was discussed above in the section titled, "Funding the Enhanced Package."

Although the BRC suggests it is important to fund the programs and services in the $8.5 million Enhanced Package, this amount represents only 50% of the original $17 million program and service enhancements reflected in Appendix H & I. And the $17 million enhancement list itself was originally $49 million but was reduced to reflect only the highest priority needs necessary to maintain current levels of service, maintain the city's inherent governmental responsibilities and provide an acceptable level of desirable services. Further, this Enhanced Package represents enhancements considered essential and desirable only through the 2017 period. Given the long-term projections in the city's Master Plan Action Plans and Vision Plans, and changes in community needs and expectations of local government, the city should anticipate that additional funding needs and demands for new programs and services will obviously emerge over the next 22 years.

The challenge for any long-range projection model rests with the major unknown factors that could subsequently occur and potentially impact the forecast. If an annual fiscal review is conducted using the format in this document and a comprehensive update of this report is completed every five years, the financial outlook will become clearer and plans can be created to proactively address new issues that may arise