STAFF REPORT TO THE FINANCE COMMISSION

DATE: Regular Meeting of September 17, 2025

TO: Members of the Finance Commission

SUBMITTED BY: Edwin Gato, Director of Finance

SUBJECT: Receive information about potential revenue-generating options.

RECOMMENDED ACTION:

The staff recommends that the Finance Commission receive the report on potential revenue-generating options. This report was presented to the City Council during its regular meeting held on July 8. Subsequently, the Council directed the staff to initiate the processes related to the tax measure initiatives.

BACKGROUND:

On May 28, 2024, the City Council formally adopted the Hercules City Council Strategic Goals for the period of 2024-2026. Among these goals, Goal #2 emphasizes the importance of improving the City's fiscal sustainability. A key objective within this goal is to investigate potential revenue sources that will effectively address both current and future needs. This report aims to present various revenue-generating options for consideration by the City Council as follows:

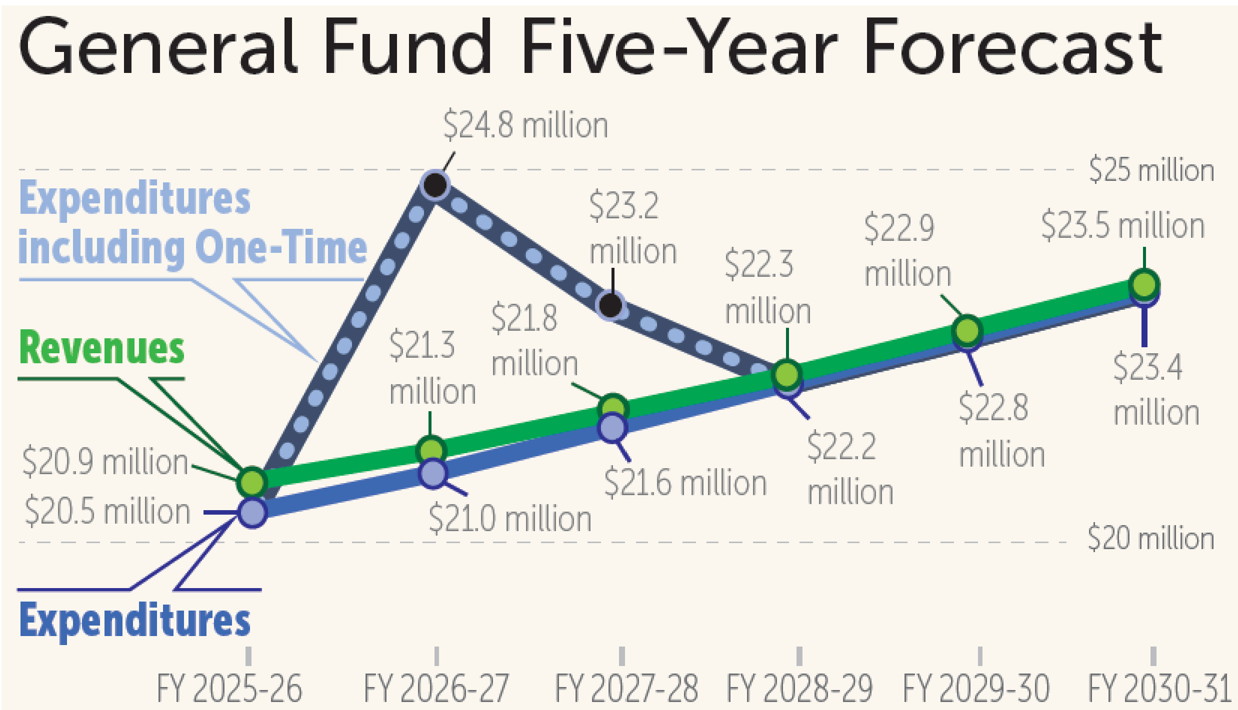
- Sales Tax
- Utility Users Tax (UUT)
- Real Property Transfer Tax (RPTT)
- Bond Financing

This revenue enhancement will increase the City's revenue to address unfunded critical infrastructure needs, rising cost of goods, services and utilities, employee retention, and deferred maintenance.

On March 4, 2025, the City hosted an informative town hall meeting to engage the public and provide education regarding the City's revenue sources. It is imperative for residents to have a clear understanding of how public funds are collected and utilized to deliver essential services and to invest in the future development of the community. This meeting served as an important platform for fostering transparency and encouraging informed participation among citizens regarding the City's financial operations.

ANALYSIS:

On June 10, 2025, the City Council presented the Five-Year Financial Forecast for the General Fund as a critical component of the budget adoption process. This forecast delineates anticipated revenues and expenditures to assess the financial health of the City and to identify emerging trends. Below, a chart is provided that summarizes the City's Five-Year Financial Forecast.

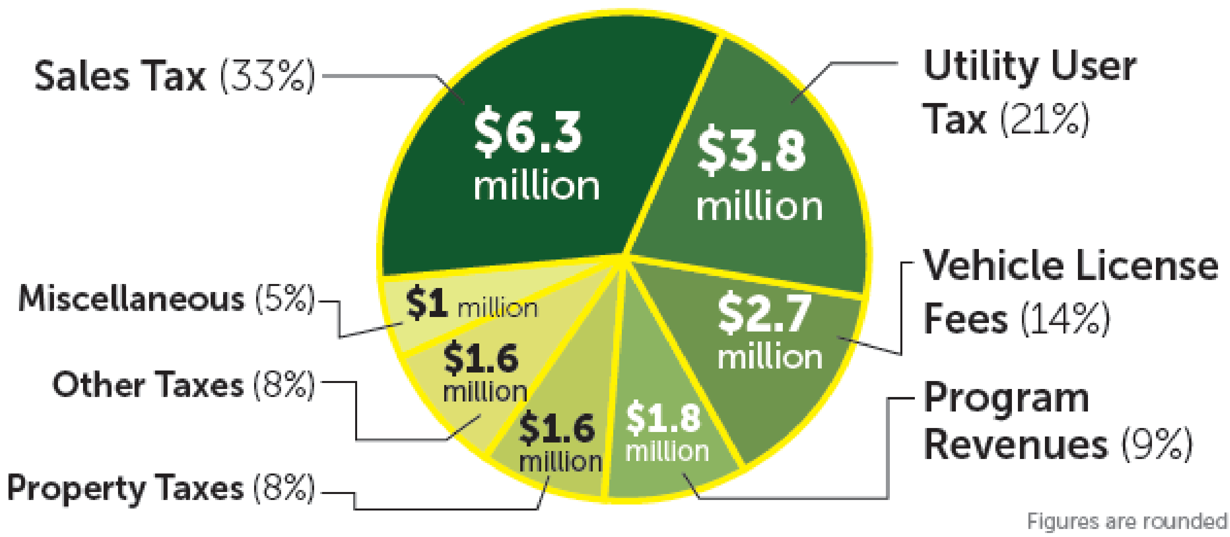


The forecast includes a planned annual 3% cost-of-living salary increase, demonstrating the City's commitment to supporting its workforce. It is based on assumptions of ongoing economic growth and a stable financial condition, indicating an expected balanced budget for the General Fund.

The City anticipates a one-time repayment to fully retire all of the California Housing Financing Authority (CalHFA) loans, in accordance with the agreement established on October 18, 2013. The City will utilize General Fund Reserve for the repayment of this loan.

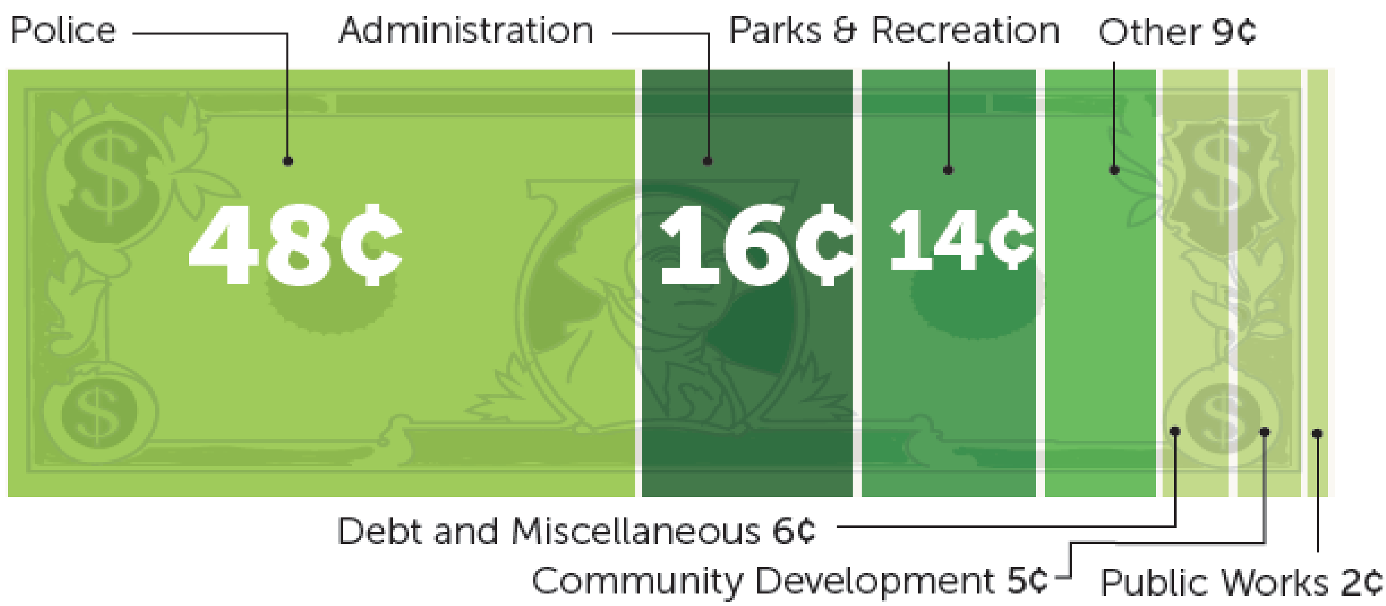
General Fund Revenue: Where does the money come from?

The General Fund revenue for a city is primarily supported by local taxes, which play a crucial role in funding essential services and initiatives. This includes a variety of tax sources such as sales tax, which is collected on retail purchases, utility users' tax imposed on services like water and electricity, and property tax based on property values. Additionally, the fund receives in lieu of vehicle license fees, user fees for specific municipal services, and other discretionary sources of revenue. Notably, a significant portion—approximately 80%—of this revenue stems from these tax contributions, highlighting taxation's vital role in the city's financial health and ability to serve its residents effectively.



General Fund Expenditure: Where does the money go?

The General Fund serves as the city's primary operating fund. It tracks the sources and uses of resources that are mainly at the discretion of the City Council for providing activities, programs, and services that the community considers necessary and desirable. Expenditures from the General Fund are strategically directed toward enhancing public safety, maintaining public infrastructure through public works, fostering community development, and enriching parks and recreational opportunities. Additionally, it supports essential administrative functions, ensuring that the city runs smoothly and effectively meets the needs of its citizens.



<u>Needs Assessment</u>

The City is currently positioned to sustain its services through existing revenue sources. However, we anticipate that long-term challenges may arise due to projected inflation in costs, particularly concerning a structural deficit within the Landscaping and Lighting Assessment Districts. It is essential to address several critical areas that require immediate attention, including the rehabilitation of major streets, enhancements to infrastructure, improvements in residents' quality of life, and the maintenance of adequate staffing levels.

The City has identified several critical needs that are either unfunded or underfunded, which impede its ability to effectively deliver essential services to the community. These needs include necessary adjustments to staff compensation to ensure that salaries remain competitive with market rates, maintaining optimal staffing levels to adequately meet service demands, and securing funding for vital capital projects that support community development. Additionally, the rising costs of goods, services, and utilities, exacerbated by inflation, must be addressed. While addressing these important needs would significantly benefit the community, it is important to recognize that doing so may place strain on the overall financial position.

While the City has the capacity to reduce expenditure, the persistent rise in the costs of goods and services may result in increased financial burdens for the community, while simultaneously diminishing the quality of services received. This dynamic ultimately leads to a decline in the overall service provision and capital improvements for the community.

The City recognizes the importance of addressing the ongoing imbalance between revenues and expenditure, particularly in light of rising costs. To proactively tackle this challenge, the City has recently implemented a series of constructive measures:

- Launched efficiency initiatives incorporating new technology and process improvements to enhance service delivery.
- Fostered greater collaboration to secure regional grants, maximizing funding opportunities.
- Increased the number of grant applications submitted to diversify funding sources.
- Engaged proactively with state and federal representatives to seek additional funding support.
- Updated the City's user fees to ensure they align with the increasing service costs.

The City also recognizes the significant importance of addressing deferred maintenance on its assets. In this context, staff have conducted thorough assessments of the Parks and Recreation systems as well as city-owned facilities, leading to the formulation of the Parks and Recreation and Facilities Master Plan. This plan aims to promote long-term financial sustainability by establishing a strategic investment framework that prioritizes essential improvements to parks, enhancements to existing facilities, and the development of new recreational areas.

In looking ahead to the next decade, staff have identified approximately over $135 million in potential Capital Improvement Plan (CIP) projects across several critical categories, including facility renovations, street and road maintenance, sewer system upgrades, park improvements, and enhancements to transportation infrastructure. It is important to note that over $100 million of these identified projects currently lacks secured funding, highlighting the urgent need for future financial investment in the City’s recreational and infrastructural initiatives.

In our efforts to address the needs of the community and sustain essential services, it is increasingly apparent that identifying new sources of revenue is critical for ensuring the City’s financial stability and long-term sustainability. By actively pursuing innovative funding opportunities and forging strategic partnerships, we seek to enhance our financial foundation, thereby improving our ability to serve our residents more effectively. These proactive initiatives will be instrumental in fostering a more robust and resilient community.

Revenue-Generating Options

Additional Tax Initiatives

The City suggests several effective strategies to establish additional and consistent revenue streams that will support the Council in achieving its goals. It is important to emphasize that implementation of these strategies will require voter approval. Moreover, we can tailor these tax structures in various formats to effectively align with the Council's specific revenue objectives.

The following is a summary of the various types of taxes that can be implemented.

1. Sales Tax
   The City has the potential to enhance its revenue by increasing the sales tax on purchases made within its jurisdiction. Local governments, which encompass both cities and counties, possess the authority to impose additional sales and use taxes to address their financial requirements. Presently, the sales tax rate in the City stands at 9.25%, while Contra Costa County has established a maximum rate of 9.75%. This provides the City with an opportunity to raise its sales tax by an additional 0.50%. Should the City choose to pursue this increase, it is projected that it could generate an additional $2 million in revenue, which could be allocated to support vital public services. The table below shows the sales tax rate comparison with nearby Contra Costa County cities:

El Cerrito	10.25%
Pinole	9.75%
San Pablo	9.50%
Hercules	9.25%

2. Real Property Transfer Tax (RPTT) or Documentary Transfer Tax
   The city of Hercules currently enforces a property tax transfer rate of $1.10 per $1,000 of property value at the time of sale. This tax is typically incurred by the buyer, the seller, or both parties involved in the transaction, with the revenue generated being allocated between the city and the county.

   It is noteworthy that only charter cities possess the authority to modify this rate through a ballot measure subject to voter approval. As Hercules is classified as a general law city, any proposal to increase the property tax transfer rate would require the city to obtain charter city status, as well as receive endorsement from the electorate.

   At the present rate of $0.55 per $1,000, Hercules generates approximately $135,000 annually from the Real Property Transfer Tax (RPTT). This revenue is vital for supporting various public services and community initiatives within the city. Based on average property sales data from 2020 to 2024, which reflects an average property price of $750,000, it is projected that the city could realize an additional $245,000 in annual revenue for every $1 increase in RPTT rates.

   A comprehensive guide for becoming a charter city to enhance the Real Property Transfer Tax (RPTT) is included in Attachment 1 for reference.

3. Utility User Tax (UUT)
   The utility users' tax (UUT) is a fiscal measure introduced in California in 1967. This tax can be applied to a variety of essential utility services that residents rely on daily, including electricity, natural gas, water, sewage disposal, and telecommunication services such as traditional landlines, mobile phones, and long-distance calling. In recent years, local governments have expanded the scope of this tax to include modern digital services, such as internet access, streaming platforms, and video conferencing applications, reflecting the evolving landscape of consumer utilities.

   The revenue generated by the UUT can vary significantly based on the specific utilities being taxed and the established tax rate. Utility companies are responsible for collecting these taxes directly from their customers and remitting the funds to the respective city governments.

   The current utility users' tax (UUT) rate for the City is set at 8%. This tax serves as a significant revenue source for the General Fund, accounting for approximately 20% of its total revenues and contributing roughly $4 million to the City's annual budget. This financial support is essential for the provision of general services. Additionally, a 1% increase in the UUT rate has the potential to generate approximately $500,000 in additional annual revenue.

As mentioned, these tax initiatives require voter approval. There are two options for election dates:

- On the date of the next regular Council election that is not less than 88 days after the Council meeting at which the petition is certified, or
- On a special election date that is between 88 and 103 days after the council meeting at which the petition is certified.

Bonds

An alternative funding option for the City is to issue bonds. This approach allows local governments to finance various projects at significantly lower interest rates than many other financing methods. The reason for this advantage is that these bonds are backed by the full faith and credit of the government entity, instilling confidence in investors and reducing the perceived risk. As a result, issuing bonds can be a financially beneficial strategy for the City to secure the necessary funds for development and infrastructure improvements.

The following is a summary of the various types of bonds that can be implemented.

1. General Obligation (GO) Bonds
   General Obligation (GO) Bonds are vital tools for local governments seeking to finance essential infrastructure projects that contribute to the well-being and

development of their communities. These bonds stand out because they are relatively inexpensive to issue due to low borrowing costs, making them an appealing choice for investors looking for secure investments.

What sets GO Bonds apart is their backing by a solid commitment to levy ad valorem property taxes. These taxes are based on the assessed value of properties within the jurisdiction and are levied without any upper limit. This commitment ensures that local governments can reliably secure the funds needed to meet their debt service obligations, giving investors' confidence in the repayment of their investment.

In practical terms, the collection of ad valorem taxes used to repay GO Bond debt is in addition to the standard one percent general ad valorem property tax currently imposed on property owners. This additional funding source provides financial stability and supports community projects that drive growth, such as roads, schools, and parks. However, it's important to note that implementing the annual property tax requires the approval of two-thirds of the voters, which adds a layer of accountability and democratic oversight.

While the issuance of GO Bonds presents numerous advantages, such as affordable financing and strong community support, there are also potential disadvantages that must be considered, outlined in the following:

Advantages

- Generates new revenue source to repay debt
- Broad-based tax support for public improvements
- Lowest interest cost due to ad valorem security and unlimited tax pledge

Disadvantages

- Time, expense and uncertain outcome of the election
- Property tax increase that is passed through to residents

GO Bond proceeds can be used for a variety of projects, including:

- **Capital Improvements:** Construction, repair, or rehabilitation of roads, highways, bridges, and parks and parks.
- **Affordable Housing:** Subsidies for affordable housing projects, and other affordable housing programs.
- **Public Safety:** Funding for public safety facilities.

2. Lease Revenue Bonds

Lease revenue bonds represent a unique structure in the municipal market. Unlike general obligation bonds, which are issued as long-term debt to finance improvements on public facilities, lease revenue bonds rely on a specifically designated internal source of repayment, such as sales tax. This approach requires a lease revenue bond structure.

However, there are limitations regarding the quality, availability, and value of essential City assets, which include facilities like city hall, police stations, and the corporation yard. In contrast, less essential assets might encompass community centers, senior centers, libraries, or older City buildings. It is crucial that the insured value of the leased assets is at least equal to or exceeds the amount of bonds being issued. For instance, a $10 million bond would necessitate $10 million worth of leased assets.

Unlike general obligation bonds, lease payments are drawn from the general fund, linking the City's creditworthiness directly to the repayment of these bonds. Generally, the rating for the general fund is one or two notches lower than that of a general obligation bond. A lower credit rating typically results in a higher interest rate for the bonds. Since the debt service obligations of lease revenue bonds are paid from the general fund, voter approval is not required.

In summary, as previously discussed, the City has identified several effective strategies for generating additional and dependable revenue streams to fulfill the Council's objectives. It is essential to note that most of these options will necessitate voter approval, thereby emphasizing the importance of community engagement in the decision-making process. Moreover, various methods are available for structuring these taxes, enabling the Council to determine the annual revenue required to achieve its objectives.

This overview aims to facilitate a productive discussion regarding potential revenue enhancements. Considering the directions provided by the City Council this evening, staff are prepared to pursue further actions, including the formulation of tailored recommendations for both tax measures and bond measures to be presented in subsequent meetings.

FISCAL IMPACT OF RECOMMENDATION:
There are no fiscal impacts associated with this report.

ATTACHMENTS:
1. Staff Report – RPTT Charter City Discussion
2. Presentation