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MEMORANDUM

To: City of Hailey, Idaho

From: Tischler & Associates, Inc. (TA)

Date: January 2, 2003

Subject: Strategies and Recommendations

I. EXECUTIVE SUMMARY

The City of Hailey retained Tischler & Associates, Inc. (TA) to conduct a fiscal impact analysis of six residential and four nonresidential development "prototypes". This memorandum, together with the prototype land use fiscal impact report, is meant to foster discussion about acceptable levels of service, revenue enhancement, growth policy and other planning, finance and budgetary issues. The following major points are discussed further in the body of this memorandum:

- Both residential and nonresidential land uses generate *net deficits* to the City under present revenue structure. However, to the extent new development on vacant land *annexed* by the City is of similar density and socioeconomic characteristics to that of the existing City development base, the fiscal results improve dramatically. This is because of the annexation fees recently adopted by the City.

- The City's present revenue structure is heavily reliant on: 1) local property tax, and 2) shared revenue from the State. This is fiscally constraining to the City since State law limits the City's growth in existing assessable property tax base and a downturn in the economy will likely result in less shared revenue from the State.

- Other than property tax, the City has no other revenue source of significance generated by nonresidential development.

- There are only a few significant new revenue options available to the City. TA recommends that the City seriously consider implementing impact fees to fund new growth's fair share of necessary capital facilities. A second option TA suggests for revenue enhancement is voter-approved taxes on retail sales, alcohol and room rentals. Nonresidents would pay a significant percentage of these taxes. It is estimated that a 1% local option sales tax could generate in the neighborhood of $785,000 annually. Additional enhancements may be available through user charges and franchise fees.

- It is important that the City weight the benefits between encouraging new retail space and increasing sales at *existing* retail space since new retail space is often accommodated at the expense of decreased sales at existing locations. Especially in light of the fact that sales tax from the State is distributed using a population-based formula, rather than point-of-sale, and the lower wages associated with retail employment can contribute to an affordable housing shortage.

II. BACKGROUND

Tischler & Associates, Inc. (TA) was retained to conduct a fiscal impact analysis of six residential and four nonresidential development "prototypes". In a prototype land use fiscal analysis, a "snapshot" approach is used that determines the costs and revenues for various land use prototypes in order to understand the impacts each land use has independently on the City's budget. The net surplus or deficit for each prototype is determined by subtracting costs necessary to serve each land use from the revenues generated. Limitations to this approach are the reliance on average costing, particularly for one-time capital costs, and the lack of consideration to the geographic location of new development. The six residential prototypes included four variations of single family-detached units reflecting different zoning classifications (LR-1, LR-2 GR and ½ acre lots and greater), duplex/townhouse units and apartments. The four nonresidential prototypes are office, commercial, hotel and industrial space.

III. REVENUE STRUCTURE CONSIDERATIONS

A. Development Prototypes Generate Net Deficits to the City

As noted previously and indicated in the table below, five of the six *residential* prototypes generate annual net *deficits* and all four *nonresidential* prototypes generate annual net *deficits*. This is an indication that the City's present revenue structure cannot provide current levels of service to new development without finding new revenue sources or raising existing rates. Without revenue enhancements, current levels of service to all residents, both current and new, are likely to decline.

Annual Net Results
City of Hailey Prototype Land Use Fiscal Analysis

	RESIDENTIAL (Per Unit)						NONRESIDENTIAL (Per 1,000 SF)			
	SF-Det. LR-1 District	SF-Det. LR-2 District	SF-Det. GR District	SF-Det. 1/2 Acre+	Duplex/ Townhouse	Apt.	Industrial	Office	Com.	Lodging
Revenue	$831	$1,095	$643	$1,380	$484	$416	$168	$358	$270	$130
Costs	$1,085	$1,161	$970	$1,219	$872	$882	$245	$647	$1,005	$160
Net Result	**($254)**	**($67)**	**($327)**	**$162**	**($388)**	**($466)**	**($77)**	**($289)**	**($735)**	**($30)**

B. Reliance on Property Tax and State Shared Revenue

The net deficits generated by the land use prototypes are due primarily to the City's General Fund revenue structure, which is heavily dependent on two sources. Property tax is the City's largest revenue source, comprising approximately 50% of total operating revenue. However, this revenue source is constrained by a State law limiting the City's growth in property tax from the "existing base" to 3% annually. Since the City is faced with cost increases each year from inflation and escalating salaries for *existing* employees, it must rely heavily on the incremental increase in property tax from new growth and annexation to fund a portion of the cost increases to serve the existing development base. As a result, staffing ratios decline, there is less revenue for growth-related capital facility construction and expenditures for maintenance and rehabilitation of existing infrastructure are delayed. In short, this property tax growth cap has led to deteriorating levels of service.

The City's second largest revenue source is state shared revenue, which comprises approximately 23% of total operating revenue. Since this revenue source is allocated to municipalities using a population-based formula, the only revenue of significance generated by nonresidential development is property tax, a primary reason for the net deficits generated by nonresidential land uses.

IV. LAND USE PLANNING CONSIDERATIONS

A. Annexation

There are several land use issues associated with annexation that should be noted in the context of the fiscal impact analysis. The first issue relates to the type of uses that benefit the City fiscally. As discussed above, of the land use prototypes evaluated, five of the six residential uses and all four nonresidential uses generate annual net deficits within the existing City boundary. To deal with annexation, the City has implemented what are known as annexation fees, a one-time fee assessed against annexed properties for their impact on the City's provision of capital facilities. As shown in the table below, when the one-time annexation fees adopted by the City are annualized over a ten-year period and credited to the residential and nonresidential prototypes, three of the six residential land uses and two of the four nonresidential land uses generate a net surplus. A third nonresidential prototype (office) is essentially fiscally neutral.

Annual Net Results - Annexed Properties
City of Hailey Prototype Land Use Fiscal Analysis

	RESIDENTIAL (Per Unit)						NONRESIDENTIAL (Per 1,000 SF)			
	SF-Det. LR-1 District	SF-Det. LR-2 District	SF-Det. GR District	SF-Det. 1/2 Acre+	Duplex/ Townhouse	Apt.	Industrial	Office	Com.	Lodging
Revenue										
Operating	$831	$1,095	$643	$1,380	$484	$416	$168	$358	$270	$130
Capital	$286	$286	$286	$286	$225	$225	$193	$416	$487	$82
Total	***$1,116***	***$1,380***	***$928***	***$1,666***	***$708***	***$641***	***$360***	***$774***	***$757***	***$212***
Costs										
Operating	$829	$906	$715	$963	$674	$678	$128	$373	$624	$92
Capital	$255	$255	$255	$255	$198	$204	$117	$274	$380	$68
Total	***$1,085***	***$1,161***	***$970***	***$1,219***	***$872***	***$882***	***$245***	***$647***	***$1,005***	***$160***
Net Result	**$31**	**$189**	**($72)**	**$417**	**($190)**	**($262)**	**$40**	**($16)**	**($354)**	**$38**

An important variable in the fiscal result for single family-detached units on lots ½ acre or more is the amount of road frontage associated with these types of units, which impacts street maintenance operating costs. From the perspective of potential annexation by the City, it is probable that these units will have a greater amount of road frontage if located outside of the City limits, particularly if they are part of a golf course community. For example, if the average road frontage unit were 235 linear feet per unit versus the assumption of 125 linear feet used in the fiscal impact analysis, these units would begin to generate net deficits to City if annexed.

A positive reason for annexation is the City's ability to exercise its control over land uses in areas that may impact City services. For example, development in areas within close proximity of the City's boundaries has the potential to demand and utilize certain City services, for which the City receives no tax revenue. Since the City recently implemented annexation fees for capital facilities, fiscally it may be in the City's best interest to pursue annexation in some cases, in order to ensure it receives revenue for the operating costs it may incur regardless.

B. Development Within the Existing City Limits

The primary land use planning issue within the existing City boundaries pertains to the types of nonresidential land uses that should be encouraged on vacant parcels and/or for redevelopment. From a fiscal perspective, all four nonresidential prototypes generate net deficits to the City under the present revenue structure. This is not surprising given property tax is the only significant revenue source generated by nonresidential development, a situation seldom seen over the course of TA's extensive national experience conducting fiscal impact evaluations. Does this mean that the City should not encourage nonresidential uses? No. Fiscal issues are only one concern. The City needs a balance of industrial, commercial and residential land uses, not only for tax base purposes, but for quality of life, environmental concerns, housing affordability, traffic and other issues. For example, jobs in the office and industrial/flex sectors are beneficial to the City from an economic perspective, providing residents with high wage jobs.

Future residential development is not as big a concern, as there is only one large undeveloped tract zoned for residential use. The majority of new housing units will come from the approximately 150 vacant single family lots in the LR zoning district and approximately 175 vacant multifamily lots in the GR zoning district. This infill development could increase the City's population by over 25%.

It is important to the note that if the City were to implement all or some of the potential revenue sources discussed later in this memorandum, it is probable that the industrial, office and lodging prototypes would generate positive results. As shown above under the discussion of annexation issues, using the annexation fees as a proxy, if the City were to implement impact fees for new development, the industrial and lodging prototypes would generate a net surplus and office development would be fiscally neutral. In terms of residential land uses, the implementation of impact fees would result in net surpluses for single family-detached units in the LR-2 and LR-1 districts in addition to the net surplus generated by single family-detached units on lots ½ acre or more.

C. Affordable Housing

Due to its natural beauty and year-round recreational opportunities, the Sun Valley region has become an increasingly attractive place for individuals to purchase second homes. As a result, the price of housing has risen dramatically in recent years. To a certain degree, Hailey has become a source of affordable housing, relative to areas closer to Ketchum. Given the problems associated with the growth cap on property tax discussed previously and the fiscal results for the more affordable housing types, the extent to which the City continues to be an affordable housing source is likely to contribute to deteriorating levels of service unless current revenue rates are increased and/or new sources implemented.

D. Retail Development

The retail prototype generates a negative result, even under the assumption the City implements impact fees. The primary reason is that sales tax in the State of Idaho is distributed using a population-based formula, rather than point-of-sale. Therefore, it is especially important that the City weigh the benefits between encouraging new retail space and increasing retail sales at *existing* retail space. New retail space is often accommodated at the expense of decreased sales at existing locations. Also, the lower wage jobs typically generated by new retail space can contribute to an affordable housing shortage, a common situation in resort area communities.

V. COST REDUCTION OPTIONS

In many communities, it is easier to reduce costs than find new revenue sources or increase rates on existing sources. Although this is generally less desirable than raising revenues, it is becoming increasingly common, as state and federal funding has decreased over time. Even as non-local revenue declined, communities have been forced to deal with infrastructure replacement issues in addition to the infrastructure needs for new growth. Some cost reduction possibilities are discussed in this section.

A. Minimize Expense Increases

An obvious way of reducing costs is to reduce expenses. Under this approach, salary and cost increases would be minimized. However, this approach may be undesirable, especially in today's economic conditions, and should be considered a last resort.

B. Reduce Levels of Service

Reducing levels of service is different than minimizing salary and cost increases. Reducing the levels of service means having more residents served by the same number of positions or facilities. Reductions in levels of service can range from longer response times from the Police and Fire Departments, less active park acreage developed, and fewer personnel to service existing and new residents. However, given that City levels of service have generally been deteriorating due to the growth cap on property tax discussed previously, this too should be considered a last resort. It is also important to note that there can be indirect, or hidden costs, associated with decreasing levels of service. For example, a reduction in the level of service for fire protection could result in higher insurance costs for the community.

C. Postpone Capital Facilities

Another option for decreasing costs in order to enhance revenues is the postponement of capital facilities. In most cases, this postponement will result in existing capital facilities providing lower levels of service. Generally, the postponement of a capital facility will result in overcrowding or over-utilization of existing facilities. It may increase operating and maintenance costs for existing facilities. By the same token, postponing planned facilities for which a present level of service does not exist, such as a new aquatic center, will also lower operating expenses since additional staffing and operating costs will not be incurred.

D. Privatization/Cost Sharing

An increasing number of jurisdictions are contracting out ("privatizing") services to the private sector or to other local governments through cost sharing. The cost for providing services is sometimes less expensive in the private sector, particularly in a very competitive market place. Two obvious disadvantages to this approach are: 1) public sector employees could be laid off if their activities are contracted out, and 2) if there are very few private sector vendors offering the service, and the City no longer has a work force to provide these activities, there could be some difficulty in starting up the service again in the public sector, if the City becomes dissatisfied with the private vendor. Examples of privatization include the use of private waste disposal companies to provide curbside waste removal, fleet management, fire and rescue, road maintenance and the use of local engineering firms to handle building permit and plan review functions (site plans, subdivisions and drainage).

Similar to privatization is what is known as cost sharing agreements. Many local governments have found that mergers of similar service activities can provide substantial cost savings by reducing administrative and equipment duplication. Such cost sharing agreements have improved local government efficiency and have led to significant cost savings. An example is the sharing of police service costs in Brown County, Wisconsin. The largest city in Brown County is Green Bay. Approximately 30 years ago, Brown County began contracting police service with the smaller villages and towns within the County. The need developed due to the high costs for police service provision the smaller villages and towns were incurring. (To build and maintain a police force, a village or town was required to invest significant dollars to build police stations, purchase and maintain equipment, and hire administrative staff and officers.)

The cost sharing arrangements are similar for each community. Under the agreement, which the County enters into with each local government, the County is responsible for and incurs the cost of providing the villages/towns with police officers, and administering the provision of police services. The villages/towns are required to provide the police officers that serve their respective jurisdictions with vehicles and the necessary equipment, such as radios and weapons. The number of officers provided to a community depends on the number of officers per shift the community desires. In each agreement, the County, pursuant to a formula that is used for all of the participating local governments, determines the amount each community will pay for police service. The formula includes the costs of regular wages and fringe benefits; indirect costs, such as support services allocation (which includes communications and evidence processing) and investigative costs, which are assigned based on a percentage of actual use.

In 2001, the Villages of Allouez and Howard paid operating costs of $545,045 and $881,165, respectively for County police services. This is considerably less than what operating costs would be if each village were responsible for operating their own departments. For purposes of comparison, per capita spending for law enforcement in Wisconsin municipalities with more than 2,500 persons was $165. In the Villages of Allouez and Howard it was $36 and $72 per capita, respectively.

The participants identify several positive aspects associated with these agreements. First, the communities enjoy cost savings with increased efficiency and better service. Due to the

County’s ability to offer higher wages and benefits, the County can attract a higher caliber of employee than the villages/towns. Additionally, the County receives back-up support from officers assigned to municipalities. Another significant advantage is that, by contracting with the County, the villages are less subject to liability concerns.

VI. REVENUE ENHANCEMENT OPTIONS

Compared to most states, Idaho municipalities are somewhat restricted with respect to the revenue sources available to fund municipal services. However, there are several revenue sources available to the City, which have not been implemented. These include impact fees for capital facilities and voter-approved taxes on retail sales, alcohol and room rentals. The City should give strong consideration to the voter-approved taxes, as they are relatively easy to administer and broaden the tax base to include non-residents. To develop fair, practical and effective ways to increase revenues, it is recommended that attention be paid to the following characteristics: equity, economic development, adequacy, ease of administration and legal feasibility.

A. Property Taxes

The property tax has been the largest source of revenue for the operating needs of the City and is the primary local revenue dedicated to infrastructure as well. Property taxes comprised 49% of the FY2002 General Fund Operating Budget. As discussed previously, the City’s growth in property tax is constrained by State law, which limits the growth in property tax from the “existing base” to 3% annually. Therefore, “real” growth in the property tax base is the annual increment added from new growth and annexation.

When a community needs to increase revenue, the first source usually considered is the largest revenue source, which is generally property tax. Because of State law, increasing the property tax rate requires approval by 60% of registered voters. Given that the City has not implemented several revenue sources for which it has enabling legislation, TA recommends that an increase in the property tax rate be given low priority, relative to other options for revenue enhancement.

B. Impact Fees

Impact fees can be defined as new growth’s fair share of the cost to provide necessary capital facilities. In determining the reasonableness of these one-time fees, the fee must meet three requirements: 1) needed capital facilities are a consequence of new development; 2) fees are a proportionate share of the government's cost; and 3) revenues are managed and expended in such a way that new development receives a substantial benefit. These requirements are discussed further below.

Impact fees cannot be imposed on new development to pay for or provide public improvements needed by the existing development base. Capital improvements funded by impact fees must enable the City to accommodate new development by adding facility capacity. To be proportionate, new development should pay for the capital cost of infrastructure according to its "fair" share of impact on a particular public facility. To ensure impact fees are proportionate, the cost allocation methodology should consider variations by type of development and type of public facility. As appropriate, capital cost assumptions must consider the net cost of facilities after accounting for grants, intergovernmental revenues and other funding sources. The reasonable connection between the impact fees and the benefit requires that funds be earmarked for use in acquiring capital facilities to benefit the new development. Substantial benefit also requires consideration of when the fees are spent. This substantial benefit test often leads communities to set up collection and expenditure zones for public facilities that have general geographic service areas.

The Idaho Development Impact Fee Act (the Act) is one of the more restrictive in the country. It limits impact fees to water, sewer, roads, parks/recreation/open space and public safety. It excludes categories such as libraries and municipal facilities (housing administrative functions). In addition, it excludes capital equipment such as vehicles and fire apparatus. The Act also requires that any capital improvements funded by impact fees have a useful life of at least ten years.

The Act defines a specific process for implementing the fees. This includes establishing an impact fee advisory committee, adopting land use assumptions in a capital improvement program (CIP), adopting an impact fee ordinance and setting up implementation mechanisms that include preparing an annual report on collections and expenditures. If the fees are not spent within five years of collection, they must be refunded. The exception is utilities, in which case the time period is 20 years. The calculation of the impact fees needs to reflect actual costs or reasonable estimates and the level of services upon which the fee is based has to be the same for existing as well as new development. In other words, a higher level of service cannot be charged against new development than that which currently exists. The usual requirements for calculating impact fees are also stipulated, such as calculating credits as appropriate to avoid any double payment, establishing collection and expenditure zones as appropriate to meet the rational nexus requirements, and providing a reasonable and fair formula to establish the proportionate share. The result should be a schedule of fees for different types of relevant land uses.

As noted previously, the Act requires the adoption of a capital improvements plan. The plan would need to identify service units attributable to new development, project demand for the improvements up to 20 years; describe the system improvements and their costs and identify all sources and level of funding. The last point will further indicate that impact fees will be paying their proportionate share of the total cost.

The major advantages of implementing impact fees is that they can help a local government meet capital facility needs without raising taxes; shift the fiscal burden for growth related capital facilities to new development; and are attractive politically, since they pass on cost to future (absentee) voters. A major disadvantage is that since fees are collected from new growth only, they do not ensure a steady revenue stream.

The City is authorized to implement impact fees under State enabling legislation, but has not done so to date. However, as discussed previously, the City has implemented annexation fees. These annexation fees, calculated for the City by TA, are similar to impact fees, but are charged only against annexed properties. As shown above under the discussion of land use planning considerations, the City should give strong consideration to implementing impact fees as a way to help ameliorate new growth’s impact on the City’s provision of capital facilities, as the implementation of this revenue source alone will result in positive fiscal results for several land use categories. Although there are costs associated with the administration of impact fees, they are relatively minor.

C. Local Option Sales Tax

As a city that derives a significant portion of its economic well-being from activities related to the recreational opportunities afforded by the Sun Valley region, Title 50 of the Idaho Code authorizes the City to implement a local option sales tax, subject to approval by 60% of registered voters. A local option sales tax is percentage added to the purchase price of goods sold, and is a particularly attractive way to generate local revenue, especially in communities where the levying of property taxes has been restricted and there are considerable sales to outside residents, both of which apply to Hailey. The City currently receives a shared portion of sales tax from the State and County, but has not implemented a local option sales tax. A local option sales tax is attractive because it is relatively easy to administer and broadens the tax base to include non-residents. Although sales tax revenue will vary with spending trends and are therefore less reliable than property tax revenues, its potential as a City revenue source should not be overlooked. For example, it is estimated that there is approximately 245,000 square feet of *existing* retail-related space (including hotel/motel space) in the City. Assuming sales per square foot of $320 (from Dollars & Cents of Shopping Centers, 2002, Urban Land Institute), total retail sales in the City can be estimated at $78.4 million. A one percent sales tax would net the City approximately $784,000 annually from the *existing* base.

D. Occupancy Tax

A sizable revenue source for many communities throughout the country is the occupancy tax, which is essentially a sales tax added to nightly room rentals. Title 50 of the Idaho Code also authorizes the City to implement an occupancy tax upon hotel, motel and other sleeping accommodations rented or leased for a period of thirty days or less, subject to approval by 60% of registered voters. Similar to the local option sales tax, an occupancy tax is attractive because it is relatively easy to administer and broadens the tax base to include non-residents. In TA's opinion, this revenue source should be given strong consideration.

E. Alcoholic Beverage Tax

The City currently receives revenue from the sale of alcoholic beverage licenses, as well as a shared portion of the State liquor tax. It does not, however, have a tax on the sale of wine and beer sold at retail locations, or upon the consumption of liquor by-the-drink on licensed premises. Similar to the local option sales tax and the occupancy tax discussed above, Title 50 of the Idaho Code also authorizes the City to implement an alcoholic beverage tax, subject to approval by 60% of registered voters. In TA's opinion, this revenue source should be given strong consideration.

F. Franchise Fees

Franchise fees are fees charged to the utility companies by the City for the use of its streets and right of ways, and as the right to do business in Hailey. The City has implemented franchise fees for electricity, cable television, and natural gas. This revenue source totals approximately $80,000 in the FY2002 budget. The City recently approved a franchise fee for solid waste removal goes into effect in April of 2003. TA feels this revenue source offers the City a strong opportunity for revenue enhancement. For example, with the addition of the solid waste franchise fee and an increase of 1% to the electric franchise fee could conservatively add $50,000 to the City's General Fund.

G. User Charges

Similar to pricing for privately produced goods and services, user charges can be an efficient means of paying for local government operating expenses, maintenance of facilities, and to retire revenue bonds used to finance construction. User charges allow a local government to recover costs for providing a variety of services and can be structured in a variety of ways. Some fees, such as those for waste collection, are based on a flat monthly fee. Others are generally tied to a level of use or are based on a direct, identified cost to provide a service, such as the plan review, processing and inspection costs related to a building permit. User charges are attractive for several reasons. First, since users pay for what they consume, there is a direct relationship between the benefit received and the fee charged. Secondly, by permitting agencies to be self-supporting, user charges promote administrative efficiency. Finally, user charges are applied to both existing and future residents alike

The City currently has several user charges in place, such as the fees associated with building permits, plan review and building inspections. To the extent the City is not covering the cost to provide services with user charges presently in place, strong consideration should be given to increasing existing rates. There may be situations where City services are being provided for which user charges are deemed appropriate and are currently not in place. In these cases, the City should consider implementation of appropriate user charges.

H. Special Taxing Districts

A special taxing district, sometimes known as a municipal service district (MSD), permits the taxation of property owners within certain geographic boundaries to fund special local government services provided within the service district. Revenues raised by an MSD can be used to pay for both operating and capital expenses. Depending on state law, the MSD may be managed by the municipal government or by an autonomous governing body with the power to levy taxes and borrow funds. Municipal service districts can be implemented for a variety of different services. The most common are for fire/rescue, police, parks and recreation, libraries and sewer/water.

Municipal service taxing units (MSTUs), a form of a special taxing district, are used extensively throughout the State of Florida to pay for local utilities and services. For example, Hernando County has multiple MSTUs to address fire and rescue needs. Ponte Verde Beach has used special taxing districts to fund and manage a variety of projects including parking, road improvements, utilities, drainage projects, police protection, trash collection and ambulance operations.