

March 27, 2008

# **Supplement to Major Milestones: 35 Years of the State-Local Fiscal Relationship**

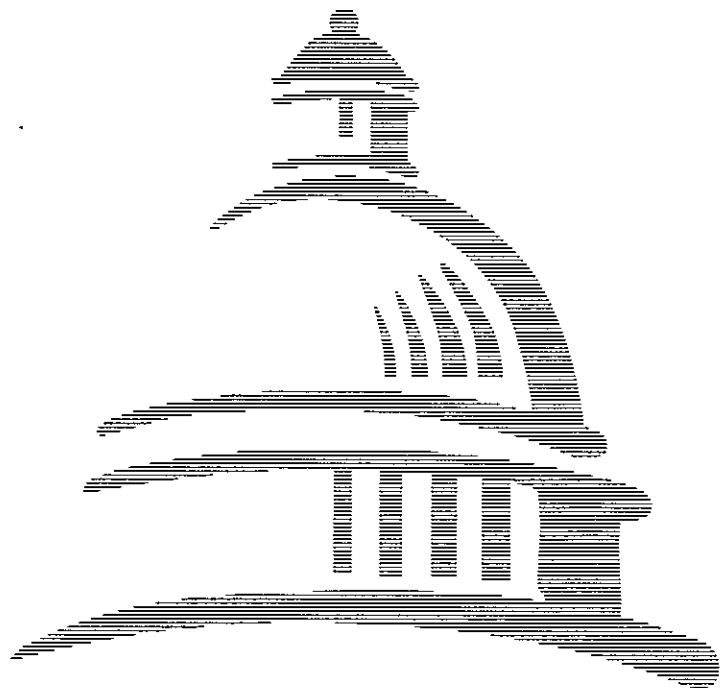
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LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Budget and Fiscal Review Committee

Hon. Denise Moreno Ducheny, Chair





## Themes in State-Local Fiscal Relations

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### Throughout the Nation

- When multiple governments serve the same people, tensions inevitably arise over which level of government makes the rules for public services and which level of government pays the bills.
- A strong state role in local finance makes sense if the state's objective is to maximize equity in the allocation of public resources—for example, school equalization. A strong local role makes sense if the state's goal is to foster experimentation, innovation, or responsiveness to local preferences—for example, local parks and public safety.
- The government that raises the revenue generally sets the rules as to how funds are spent.
- If local government does not reduce program costs to reflect state funding limitations, interest in replacement revenues inevitably emerges.
- To promote the best program outcomes and reflect current public preferences, state and local program responsibilities should be reevaluated and resorted periodically.



### Particularly Notable in California

- Given the size and diversity of California, it is difficult for the state to gauge each local government's needs and preferences. As a result, state funding formulas often default to sealing in place revenue distributions made years—or decades—earlier.
- County shares of program costs and school property taxes have played a role as a state-local fiscal balancer.
- The lines between state and local resources—and state and local responsibilities—have blurred, making it difficult for Californians to know which level of government to hold accountable and causing inter-governmental tension.



## Proposition 13 of 1978 (Including Subsequent Amendments)

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### Provisions

- **Property Tax Limit.** The maximum property tax rate is 1 percent of the “full cash value” of the property. Any property tax rate approved by two-thirds of local voters for debt is in addition to the 1 percent rate.
- **Assessment Limit.** Full cash value is determined when a property changes hands, or 1975-76, whichever is later. Increases in assessed value are limited to 2 percent annually, or the consumer price index, whichever is less.
- **Allocation of Property Tax.** Property tax revenues are to be collected by the counties and apportioned “according to law.”
- **New or Increased Taxes.** New or increased state taxes must be approved by two-thirds of the Legislature. Local governments may impose “special taxes” if they are approved by two-thirds of the local voters.



### Legislature’s Post Proposition 13 Implementation Decisions

- Whether and how to help local governments respond to this reduction in revenues.
- Whether any state relief would be temporary or permanent.
- How property taxes would be allocated among several thousand local governments.



# LAO, *Cal Facts*, December 4, 2006

20

STATE-LOCAL FINANCES

## Paying for County, City, and Special District Services

2003-04

	Counties	Cities	Special Districts <sup>a</sup>
<b>Total Revenues (In Billions)</b>	\$46.3	\$42.8	\$8.6
<b>Sources of Revenues</b>			
Property taxes	13%	7%	24%
Sales and other taxes	7	28	—
User charges, permits, assessments, fines	20	43	53
Intergovernmental aid	52	8	12
Other revenues	9	13	11

<sup>a</sup> Nonenterprise special districts only.

- Counties receive roughly half of their revenues from the state and federal government and must spend these funds on specific health and social services programs. About one-fifth of county revenues come from local taxes. Counties use tax revenues to pay for public protection and other local programs, as well as paying the required “match” for state and federal programs.
- Cities receive over 40 percent of their revenues from various user charges. Cities use these funds to pay for electric, water, and other municipal services. Over one-third of city revenues come from local taxes, the largest of which is the sales tax. Cities spend about one-fourth of their revenues on public safety programs, such as police and fire.
- Special district financing varies significantly based on the type of service the district provides.

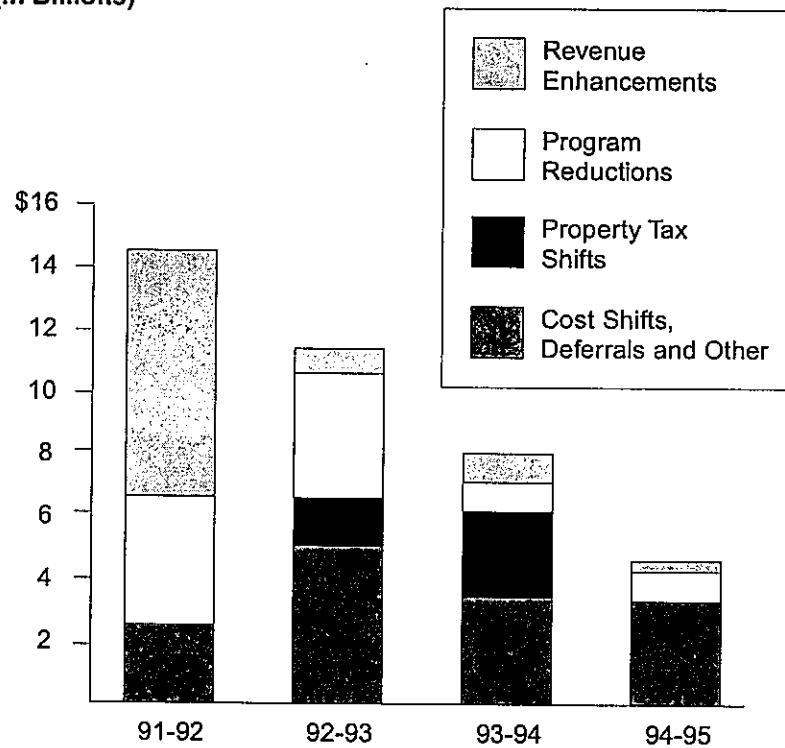


# LAO, *Reversing the Property Tax Shifts*, April 2, 1996

**Figure 1**

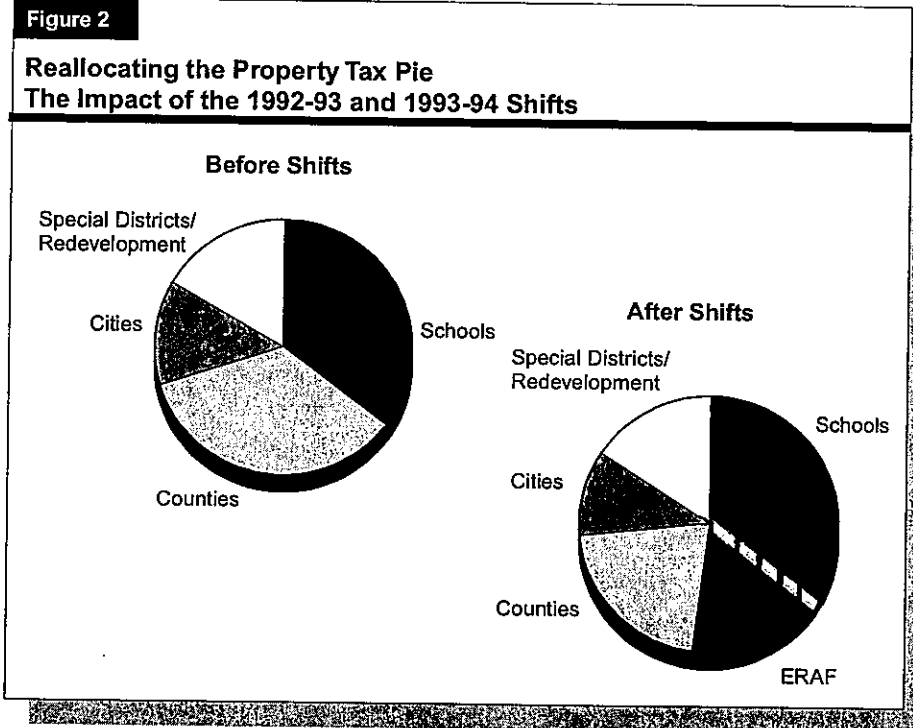
## Strategies to Address Budget Gaps 1991-92 Through 1994-95

(In Billions)





# LAO, *Reversing the Property Tax Shifts*, April 2, 1996





# LAO, *Shifting Gears: Rethinking Property Tax Shift Relief*, February 2, 1999

**Figure 2**

## Relief Measures Associated With Property Tax Shifts

### Measures Closely Linked to the Tax Shift

- Proposition 172.** Provides one-half cent in sales tax revenues annually to counties and cities. These funds (\$1.9 billion in 1998-99) must be spent on public safety purposes. The funds do, however, indirectly "free up" local general purpose revenues for other purposes.
- Trial Court Funding Relief.** State assumed growth in trial courts costs, absorbed all trial cost in small counties, and reduced costs to other counties. Relief "frees-up" about \$472 million of local government general purpose revenues in the budget year.
- The Citizens Option for Public Safety (COPS) Program.** \$100 million statewide to cities and counties to augment front line law enforcement. Annually appropriated in the budget.
- General Assistance.** State granted counties authority to reduce grant levels through the "fiscal distress" (SB 1033) process; to "count" the in-kind value of medical, housing, and other assistance; and to place a time limit on employable people receiving aid. County savings are unknown, potentially \$100 million or more annually.
- Fines and Forfeiture Funds.** Cities and counties receive a greater share of revenues from tickets issued for moving traffic violations. Funds may be used for general purposes. Relief probably exceeds \$62 million annually.
- Property Tax Administration Loan Program.** Provides annual forgivable loans to counties for property tax administration. Counties benefit from increased property tax yields. Program authorized for several years at \$60 million.
- Teeter.** Authorized a one-time mitigation of the property tax shift (totaling \$292 million) from counties which elected to make certain changes to the distribution of delinquent property taxes.

### Measures Influenced by the Tax Shift

- California Work Opportunity and Responsibility to Kids (CalWORKs).** Program changes and hundreds of million of dollars in new fiscal incentives, a portion of which may be available in the future for other county programs.
- Disproportionate Share Hospital Program.** State implemented new program to provide federal funds to county and private hospitals. Program typically provides hundreds of millions of dollars to counties annually.
- County Juvenile Probation Services.** State funds (approximately \$200 million) for operations. Annually appropriated in the budget.
- Public Library Foundation Program.** State funds (\$39 million) for public libraries. Annually appropriated in the budget.
- Adult Protection Program.** State provided \$20 million in current year for an expanded county program.



## LAO, Cal Facts, December 4, 2006

STATE-LOCAL FINANCES

19

### Extensive Use of Redevelopment by Local Agencies in Some Counties

	Percent of 2004-05 Countywide:	
	Property Value Under Redevelopment	Property Taxes to Redevelopment
<b>Top Four Counties</b>		
Butte	38%	26%
Riverside	33	24
San Bernardino	35	25
Santa Cruz	26	16
<b>Statewide Average</b>	15	10
<b>Selected Other Counties</b>		
Los Angeles	16%	10%
Sacramento	7	5
San Francisco	7	7

- If a city or county creates a redevelopment project area to address urban blight, its redevelopment agency receives the future growth in property taxes from the area. (Absent redevelopment, schools and other local agencies receive these tax revenues.)
- Redevelopment projects range from 2 acres to over 46,000 acres. Local agencies in four counties have placed so much property under redevelopment that more than one-quarter of their countywide assessed property value is under redevelopment.
- Statewide, redevelopment agencies receive 10 percent of property taxes paid by property owners, but this percentage varies significantly at the local level. The City of Fontana's redevelopment agency receives more than 77 percent of property taxes paid in the city.





# LAO, Cal Facts, December 6, 2004

16

STATE-LOCAL FINANCES

## Approval Requirements for State and Local Revenues

State Level	Legislative Approval	Voter Approval
Taxes	2/3	None
General obligation bonds	2/3	Majority
Other debt <sup>a</sup>	Majority	None
Fees	Majority	None
Local Level	Governing Body Approval	Voter Approval
City or county "general" taxes (revenues used for unrestricted purposes)	2/3 (Majority for charter cities)	Majority
City or county "special" taxes (revenues used for specific purposes)	Majority	2/3
All school or special district taxes	Majority	2/3
City, county, and special district general obligation bonds	Majority	2/3
K-14 district general obligation bonds	2/3	55 percent <sup>b</sup>
Other debt <sup>a</sup>	Majority	None
Property assessments	Majority	Majority of property owners. Votes weighted by assessment liability
Property-related fees	Majority	2/3 of voters or majority of property owners <sup>c</sup>
Fees—all other	Majority	None

<sup>a</sup> Includes revenue and lease-revenue bonds and certificates of participation.

<sup>b</sup> Exceptions: The State Constitution (1) requires approval by two-thirds of voters if the district does not meet certain requirements, and (2) specifies that a majority of voters can approve bonds used for repairing or replacing unsafe public school buildings.

<sup>c</sup> No vote required for gas, electric, water, sewer, refuse, or developer fees.



# LAO, *Cal Facts*, December 4, 2006

18

STATE-LOCAL FINANCES

## California's Property Tax Has Changed Significantly

*Dollars in Billions*

Years <sup>a</sup>	Tax Distribution				
	Revenue	Schools	Counties	Cities	Other <sup>b</sup>
1977	\$10.3	53%	30%	10%	7%
1979	5.7	39	32	13	16
1994	19.3	52	19	11	18
2005	35.4	34	28	19	19

<sup>a</sup> Information for 1977 includes debt levies. Data for 2005 is estimated.

<sup>b</sup> Redevelopment agencies and special districts.

- 1977—Before 1978, local agencies determined the property tax rate and its distribution of revenues.
- 1979—Proposition 13 (1978) set a maximum tax rate of 1 percent and shifted control over the distribution of property taxes to the state. The state basically prorated these revenues among local agencies except that it gave a smaller share to schools and backfilled the schools' losses with state aid.
- 1994—Facing fiscal pressure in the early 1990s, the state modified the distribution of property taxes to give a greater share to schools (thereby reducing state school spending).
- 2005—The state shifted a greater share of property taxes to cities and counties to offset their losses due to the (1) reduction in the vehicle license fee rate and (2) use of local sales taxes to pay the state's deficit-financing bonds.



## Proposition 1A's Changes to Legislative Authority Over Local Finance

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### Property Tax

- The Legislature may not permanently shift property tax revenues from noneducation local governments to schools.
- The Legislature may shift property tax revenues *temporarily* from noneducation local government to schools under the following circumstances:
  - The Governor declares a “severe state fiscal hardship.”
  - Two-thirds of the Legislature votes to suspend Proposition 1A.
  - The amount of property taxes shifted in each county is limited to 8 percent of prior-year noneducation agency property taxes.
  - The Legislature enacts a statute to provide repayment within three years.
- The Legislature may not change any city, county, or special district’s share of the property tax without a two-thirds vote of both houses of the Legislature.
- The Legislature may not use property taxes to reimburse noneducation agencies for mandated programs.



## Proposition 1A's Changes to Legislative Authority Over Local Finance

*(Continued)*

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### **Sales Tax**

- With minor exceptions, the Legislature may not reduce any local sales tax rate, limit existing local authority to levy a sales tax, or change the allocation of local sales tax revenues.
- Legislature may not extend the "triple flip" or reduce the property taxes provided to cities and counties as replacement for the local sales taxes pledged to pay debt service on state deficit-related bonds.



### **Vehicle License Fee (VLF)**

- The Legislature may not reduce the VLF rate below 0.65 percent, unless it provides replacement funding to cities and counties.
- If the Legislature increases the VLF rate above 0.65 percent, there are no restrictions on the Legislature's use of these additional revenues.



## Proposition 1A's Changes to Legislature's Mandate Reimbursement Requirements

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- Proposition 4 (1979) generally requires the state to reimburse local governments for mandated new programs or higher levels of service.
  
- Proposition 4 did not:
  - Set a time line for the state to make reimbursement payments.
  - Specify whether a state action to change a local government's share of a cost for a program constituted a reimbursable mandate.
  
- Proposition 1A (2004) requires the state to pay mandate bills in the annual budget, or suspend or repeal the mandate.
  - Does not apply to education or employee relations mandates.
  - Allows mandate bills from before 2004 to be paid over time.
  
- Proposition 1A (2004) expands the definition of a mandate to include transfers of financial responsibility from the state to local government. Specifically, Proposition 1A says transfers may be reimbursable mandates if:
  - the program shift is by the Legislature to cities, counties, and special districts.
  - The program is required, not optional.
  - The state previously had financial responsibility for it.



## Major LAO Publications on the State-Local Fiscal Relationship

LAO Publication	Date
<i>Parole Realignment: LAO Alternative Budget Package</i>	March 10, 2008
<i>Realignment Revisited: An Evaluation of the 1991 Experiment in State-County Relations</i>	February 6, 2001
<i>Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes</i>	February 3, 2000
<i>Shifting Gears: Rethinking Property Tax Shift Relief</i>	February 2, 1999
<i>A Primer on the Vehicle License Fee</i>	June 17, 1998
<i>Why County Revenues Vary: State Laws and Local Conditions Affecting County Finance</i>	May 7, 1998
<i>A Perspective on the Vehicle License Fee</i>	February 18, 1998
<i>ERAF and the 1997-98 State Budget</i>	June 18, 1997
<i>Property Tax Shift</i>	February 19, 1997
<i>A Perspective on County Fiscal Restraints, P&amp;I (p. 115-124)</i>	February 1996
<i>Understanding Proposition 218</i>	December 1996
<i>Property Taxes—Why Some Local Governments Get More Than Others</i>	August 21, 1996
<i>Reversing the Property Tax Shifts</i>	April 2, 1996
<i>Redevelopment After Reform: A Preliminary Look</i>	December 29, 1994
<i>Making Government Make Sense: Developing a Reform Proposal</i>	July 21, 1994
<i>The 1991-92 State and Local Program Realignment, P&amp;I (p. 103-136)</i>	February 1992
<i>The County-State Partnership, P&amp;I (p. 159-188)</i>	February 1991



## Other LAO Publications on the State-Local Fiscal Relationship

LAO Publication	Date
<i>Improving the Mandate Process</i>	February 21, 2007
<i>Allocating Local Sales Taxes: Issues and Options</i>	January 24, 2007
<i>What is a Mandate: Learning Through Examples</i>	January 16, 2007
<i>What Is a Mandate: An Overview</i>	January 16, 2007
<i>State Oversight of Redevelopment</i>	November 18, 2005
<i>An Assessment: Governor's Local Government Proposal</i>	May 24, 2004
<i>Vehicle License Fee Issues</i>	February 18, 2004
<i>Booking Fees</i>	February 18, 2004
<i>Mandates: Mounting Liabilities and Need for Reform</i>	February 18, 2004
<i>Another Property Tax Shift?</i>	February 18, 2004
<i>Mandates: Overview of Process and Issues</i>	May 28, 2003
<i>Water Special Districts: A Look at Governance and Public Participation</i>	March 15, 2002
<i>Peace Officer Procedural Bill of Rights (POBOR) mandate</i>	February 20, 2002
<i>The Vehicle License Fee and the 2002-03 Budget</i>	February 20, 2002
<i>Property Tax Administration Funding Not Ideal Approach</i>	February 17, 2000
<i>California Counties: A Look at Program Performance</i>	May 21, 1998
<i>Proposition 172—How Did It Affect Spending for Public Safety?</i>	June 9, 1994
<i>Common Cents—Background Material on State and Local Government Finances</i>	October 1993
<i>Enterprise Special Districts, P&amp;I (p. 88-93)</i>	February 1992
<i>Accommodating California's Growth, P&amp;I (p. 97-110)</i>	February 1989
<i>Trial Court Funding and County Finances, P&amp;I (p. 337-349)</i>	February 1989
<i>The Governor's 1995-96 State-County Realignment Proposal, P&amp;I (p. 133-151)</i>	February 1995
<i>Restructuring the State-Local Relationship, P&amp;I (p. 109-136)</i>	February 1994
<i>Making Government Make Sense: Applying the Concept in 1993-94</i>	May 1993
<i>Making Government Make Sense: A More Rational Structure for State and Local Government, P&amp;I (p. 111-132)</i>	February 1993
<i>Restructuring Government in California, P&amp;I (p. 101-109)</i>	February 1993