Agenda Report

TO: CITY COUNCIL **DATE:** September 13, 2004

THROUGH: LEGISLATIVE COMMITTEE (9/7/04)

FROM: CITY MANAGER

SUBJECT: SUPPORT PROPOSITION 1A – Local Government Funds, Revenues and OPPOSE PROPOSITION 65 – Local Government Funds, Revenues

RECOMMENDATION

It is recommended that City Council:

1. Support Proposition 1A – Local Government Funds, Revenues
2. Oppose Proposition 65 – Local Government Funds

BACKGROUND

The California Constitution requires that specified revenues derived under the Vehicle License Fee (VLF) Law be allocated among the counties and cities of the state according to statute. Existing statute requires that a specified percentage of the revenues derived under the VLF Law be deposited in the Local Revenue Fund in the State Treasury for allocation among counties and cities for specified purposes.

For more than a dozen years, the state legislature has been taking local tax dollars that local governments use to provide vital services like fire protection, paramedic response, law enforcement, healthcare, parks and libraries. The State has taken more than $40 billion from cities, counties and special districts in the last 12 years. If these raids continue, it could mean fewer firefighters, fewer law enforcement officers and longer waits at emergency rooms -- or higher local taxes and fees

PROPOSAL

Prop 1A prevents the State Legislature from taking and using local government funds. Prop 1A would keep more of our local tax dollars local and would protect funding for vital local services like fire and paramedic response, law enforcement, healthcare, parks, libraries, and transportation. Specifically, Proposition 1A:

- <u>Restricts the State Legislature's ability to raid local government funding</u>, including local government share of existing sales taxes, property taxes and VLF revenues.

- Protects funding for local services like fire and paramedic response, law enforcement, emergency and trauma care, parks, roads, libraries, transportation and more.
- Requires the State to provide funding for any program or service the State forces local governments to provide. If the State fails to provide funding, Legislature must suspend these state-mandates.
- Provides flexibility in a state budget emergency. Prop 1A allows the State to borrow local government revenues if funds are needed in fiscal emergency to support schools or other state programs.

Proposition 65

A coalition of local government officials placed Proposition 65 on the ballot earlier this year to stop the State from taking local government funding. However, that was before passage of the agreement that put Prop 1A on the ballot. Prop 1A is a better, more flexible approach to protecting local services and local tax dollars. City Council had previously taken a Support position for Proposition 65, however, cities are now being asked to transfer their support position to Proposition 1A. Therefore, Council is asked to withdraw their Support position for Proposition 65 and take an Oppose position.

FISCAL IMPACT

While this measure does not protect redevelopment revenues it does take a step in the right direction to prevent the State Legislature from taking and using local government funds. This measure makes it more difficult for the Legislature and the Governor to shift property tax revenues from local governments and prohibits the Legislature from reallocating local sales tax revenues. Since 1980, $70 million has been diverted from the City of Pasadena by the Legislature.

If passed by the voters, Prop 1A will require the State to pay back with interest any funds it takes from local government. In fact, before such funds can be diverted, the Governor will have to declare a fiscal emergency and the legislature with a 2/3 vote will have to authorize the loan.

Respectfully submitted,

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Proposition 1A – "Protection of Local Government Revenues": Constitutional Protection for Local Government Revenues

Questions and Answers

Senate Constitutional Amendment No. 4 (SCA 4) enacts substantial reforms to the legislature's ability to raid the local government shares of the property tax, sales tax and vehicle license fee to pay for state programs. It will appear on the November 2, 2004, general election ballot as Proposition 1A and be entitled "Protection of Local Government Revenues".

This document contains key questions and answers about this important ballot measure, which is strongly supported by the League of California Cities.

PROPERTY TAX

Background: Proposition 13 reduced the property tax rate to $1.00 per $100 of assessed valuation countywide. This single rate replaced the multiple property tax rates imposed by local governments prior to Proposition 13. The revenue from the $1.00 rate is shared in each county by the county, the cities, the special districts, and the schools. Each jurisdiction's share of the $1.00 rate was based originally upon the property tax rates in effect prior to Proposition 13. The shares have been modified over the years by the Legislature.

1. What's the basic protection for the property tax in Proposition 1A?

Proposition 1A will end the practice of state raids on local property tax, by allowing only two loans within a 10 year period – and those may occur only if the state meets certain criteria.

Specifically, Prop. 1A prevents the Legislature from reducing the combined property tax shares of cities, special districts, and the county, except to borrow the funds on a temporary basis to address a "severe state fiscal hardship". If, for example, on November 3, 2004, the property tax shares of cities, special districts, and the county of the hypothetical "California County" equaled 60% of property taxes collected in that county, the Legislature cannot pass a law that reduces the percentage below 60% except to respond to a significant state fiscal problem. Additional restrictions are:

- The 2003 VLF GAP Loan must be repaid before borrowing could occur;
- The loan could only occur twice within a 10 year period;
- The loan ("the total amount of revenue losses") must be repaid with interest within 3 years, and prior loans must be repaid before borrowing could occur a second time within 10 years;
- The amount of the loan is limited to no more than 8% of the total amount of property tax allocated to cities, counties, and special districts in the previous fiscal year; and
- The reduction could only occur with a 2/3 vote of the Legislature.

2. Can the Legislature continue to reallocate property taxes on the local level?

Yes, but with a significant new restriction on that ability. Since the passage of Proposition 13, the Legislature has had the power to reallocate property taxes among local governments, but its major experience with this over the last 25 years has been to allocate city, county and special district shares of the property tax to schools through ERAF and reduce state general fund support for schools. Proposition 1A would prevent future allocations of local government shares to schools (except on a temporary basis, when the funds may be borrowed, as explained in questions 1 and 4). However, the state retains the authority to transfer property taxes among cities, counties, and special districts with a **2/3 vote** of the Legislature. Under current law, the state can make this type of transfer with a majority vote of the Legislature.

3. Could the state reallocate property taxes in order to fund a state mandate?

No. The amendments to Section 6 of Article XIII B of the state constitution specify that, "Ad valorem property tax revenues shall not be used to reimburse local government for the costs of a new program or higher level of services."

4. Does Proposition 1A allow the state flexibility to respond to a significant state fiscal problem?

Yes, by allowing the state to borrow local property tax if it first meets the criteria identified in Question #1. Beginning in the 2008-2009 fiscal year, if the state has already paid cities and counties the amount owed from the 2003-04 VLF Gap Loan (est. $1.22 billion), the governor may issue a proclamation that declares that there is a "severe state fiscal hardship" that requires the state to temporarily suspend Proposition 1A's basic protection for the property tax. Next, the Legislature must first adopt a statute with a 2/3 vote that contains a suspension of the basic protection for that fiscal year only. Then it must adopt a separate statute that requires the state to repay cities, counties, and special districts the total amount of property tax loss caused by the suspension within three years.

5. What will suspension of the property tax protection in Proposition 1A allow the state to do?

During the one-year period of a suspension, the state can take property taxes from cities, counties, and/or special districts ("local agencies") and transfer them to the schools or to some other agency that operates within the county in which the property taxes were generated. This transfer will reduce the protected property tax percentage. However, the reduction may not result in a property tax loss that exceeds 8 percent of the total amount of property tax allocated to cities, counties, and special districts in the previous fiscal year. Currently this percentage is the equivalent of roughly $1.3 billion.

6. When will local agencies be repaid if property tax is taken during a suspension period?

No later than the end of the third fiscal year following the fiscal year to which the reduction applies. If the reduction applies in the 2010-11 fiscal year, then repayment must occur no later than June 30 of 2014. Repayment will be for the "total amount of revenue losses" including interest.

7. Can the Legislature suspend the Proposition 1A protection each time there is a "severe state fiscal hardship?"

No. Suspension of the protection may only occur twice in a ten year period; and only if the VLF Gap Loan amount has been repaid; and if only any prior suspension of property tax has been repaid with interest.

8. Why was the redevelopment property tax increment not explicitly protected in the final version of SCA 4?

It was the opinion of key legislators and legislative staff that Article 16, Section 16 of the state constitution, already protects the redevelopment property tax increment. Further, the Governor insisted on the inclusion of language in the ballot arguments for Proposition 1A that declares that the redevelopment increment is already protected by the state constitution.

SALES TAX

Background: The sales and use tax laws allow cities and counties to impose the basic 1% sales tax as well as a variety of other use taxes such as taxes for transit, jails, open space, etc. The basic 1% rate is distributed back to the jurisdiction in which it was collected. Both cities and counties may increase the sales and use tax by one-quarter cent for general governmental purposes with a majority vote. Last year the Legislature

suspended one-quarter cent of the basic 1% sales tax until the state's fiscal recovery bonds are repaid.

1. What's the basic protection for the sales and use tax in Proposition 1A?

Proposition 1A prevents the state from borrowing or taking local sales and use taxes. While the measure allows the state to borrow local property shares after meeting specific criteria, Prop. 1A does not allow the state to reduce the current funding that local governments receive from sales and use tax or require that sales tax revenues be distributed based upon population rather than the location or in any other way restrict a city or county from imposing sales and use taxes in accordance with existing law.

2. What about the current suspension of one-quarter cent of the sales tax occurring as a result of the passage of Proposition 57? Does Proposition 1A require the suspension to end when the fiscal recovery bonds are repaid?

Yes. Proposition 1A prevents the state from extending the period during which the one-quarter cent is suspended; from failing to pay the property tax backfill during the period of suspension; and from failing to restore the full sales tax rate when the bonds are repaid.

3. Can the state take any action that affects the sales and use tax?

Yes. It gives the Legislature the authority to authorize two or more local agencies within a county to exchange property tax and sales tax but only if the governing bodies of each of those agencies approves a locally-negotiated exchange agreement. Voter approval is not required to make the exchange.

Additionally, the Legislature can change how sales tax is distributed if the change is required by federal law or to participate in an interstate agreement that addresses payment of sales tax for Internet purchases.

VEHICLE LICENSE FEE

Background: The constitution currently guarantees all VLF revenue to cities and counties. No particular amount of revenue is guaranteed, however, because the amount depends upon the VLF rate that is set by the Legislature. The current VLF rate is 2%. Over the past several years, the Legislature has reduced the portion of the 2% rate paid by the taxpayer and made up the difference to cities and counties through a backfill of state general funds. During this fiscal year, cities and counties have not received a backfill of state general funds even though the taxpayer is paying only 1/3 of the 2% rate (0.65%). Under Proposition 1A, cities and

counties will receive these funds in the form of increased allocations of the property tax beginning in this fiscal year.

1. What is the basic protection for the VLF in Proposition 1A?

Proposition 1A constitutionally guarantees VLF revenue to cities and counties at the rate of 0.65% of the value of a vehicle. This is a significant change for cities and counties since the constitution currently allocates the VLF to cities and counties but no specific rate is guaranteed. The Legislature will decide how much of the VLF will pay for realignment programs and how much will be distributed for general purpose local government programs.

2. What happens if the Legislature lowers the rate below 0.65%?

Proposition 1A requires the Legislature to enact a law that provides for an allocation to cities and counties equal to the difference between the revenues received from 0.65% rate and the lower rate.

3. What will cities receive in place of the 2004-05 states General Fund VLF backfill?

Beginning in the 04-05 fiscal year, and continuing each year thereafter, cities and counties will receive property tax, instead of VLF backfill from the state general fund, in an amount equal to the difference between revenues that would be received from the VLF if at the 2% rate and the revenue received from the VLF at the 0.65% rate. The additional property tax will be distributed by reducing each local agency's contribution to ERAF. The first receipt of this additional property tax will occur in the January distribution of the FY 2004-05 property tax. The amounts received in subsequent years will increase at rates corresponding to the rate of increase in local property tax within a county. The entitlement to backfill is in a statute, not in the Constitution, but the new property tax has the same protections as other parts of the property tax (see Property Tax section).

MANDATE REFORM

Background: The Constitution requires the state to reimburse local governments for state-mandated programs. The Legislature has sometimes "suspended" the mandate, rather than reimbursing local governments. There are a group of mandates that the state has determined require reimbursement for which the Legislature has never reimbursed local governments. Finally, the Legislature has not reimbursed local governments when it transfers additional responsibility for a state program or service to local governments when the local government already had partial responsibility for that program or service.

1. Does Proposition 1A strengthen the requirement to reimburse cities, counties and special districts for the costs of state-mandated programs and services?

Yes. Beginning in 2005-06, in each fiscal year's budget, the Legislature must either appropriate sufficient fund to reimburse local governments for their costs of complying with a mandate or suspend the operation of the mandate for that fiscal year.

2. Does the "fund or suspend" requirement apply to all mandates?

No. There are two exceptions. The first is for employee and employee organization related mandates. The second is for costs incurred prior to the 2004-05 fiscal year that have not been paid prior to the 2005-06 fiscal year. These costs may be paid over a five-year period beginning in 2005-06. The five-year period is established in statute, not in the Constitution.

3. What happens when the state transfers additional responsibility for a program or a service that the local government already had some responsibility for?

Proposition 1A defines "mandate" to include a transfer of additional responsibility for a state program or service.