

LOCAL GOVERNMENT

This section reviews budget proposals that affect the general financing of local governments. Other proposals in specific program areas—health, social services, transportation, and courts, for example—also affect local governments. Those proposals are discussed under the relevant program area.

Vehicle License Fee Backfill (Item 9100-Tax Relief)

Under the California Constitution, the VLF is a state-imposed tax, but the revenue, except for administrative and collection costs, is dedicated to cities and counties. The basic VLF rate (applied to the depreciated value of vehicles) is 2 percent. Since 1999, existing law has provided for a state General Fund offset to the VLF rate (now 67.5 percent of the full amount). The offset is deducted from the VLF amount assessed to vehicle owners (reducing their tax to an effective rate of 0.65 percent).

In providing VLF tax relief, the Legislature determined to finance that relief from the state General Fund, rather than by a reduction in local revenue. Accordingly, it provided for the General Fund to backfill the VLF revenue reduction to cities and counties through the offset payment mechanism. Existing law also includes a "trigger" provision that automatically restores the effective VLF rate upon a finding insufficient funds that the General Fund has to make the offset payments to local governments.

- ◆ **Actions in the 2003-04 Budget.** In June 2003, the previous administration, with the concurrence of the State Controller, made a finding of insufficiency resulting in a restoration of the full VLF rate effective October 1, 2003. Furthermore the 2003-04 Budget Act eliminated VLF backfill payments to local governments for the 2003-04 fiscal year (effective July 1, 2003). These actions achieved a full year of backfill savings for the state.
 - ◆ **VLF Gap Loan and Hardship Allocations.** From a local perspective there was a funding "gap" during the period between July 1, when backfill payments were to end, and October 1, when revenue from VLF payments would be fully restored. The 2003-04 Budget estimated the gap amount attributable to 2003-04 at \$825 million. AB 1768 (Committee on the Budget)

requires the state to repay local governments for their gap loss by August 2006. AB 1768 (Committee on Budget) also authorized, but did not appropriate, up to \$40 million for General Fund "hardship" payments to local governments that would experience a fiscal hardship due to the VLF gap. The legislation specified that hardship included cities that rely on the VLF for more than 37 percent of general revenue, newly incorporated cities; and cases in which the delay in gap funding could compromise the ability of a local government to pay debt backed by VLF revenues. The \$40 million was to be prorated if valid claims exceeded this amount. As of January 2004, the Controller had forwarded \$59.5 million of hardship claims for payment approval by the Department of Finance, pending an appropriation of funds. The Controller separately also has paid about \$25 million of gap funding to Orange County under special provisions in existing law related to the county's bankruptcy recovery debt.

Actions by the Current Administration:

- ◆ **Trigger Determination Rescinded.** On November 17, 2003, Governor Schwarzenegger issued an executive order finding that the June 2003 VLF trigger determination was in error. Pursuant to this order, the Department of Motor Vehicles (DMV) immediately reduced the VLF rate (back to 0.65 percent) and is providing refunds to taxpayers that had paid the full VLF rate. The governor, at that time, requested a legislative appropriation to restore backfill payments to local governments.

- ◆ **Backfill Payments Unilaterally Restored.** On December 18, 2003, the Director of Finance notified the Legislature, that she had approved an emergency deficiency authorization under Section 27.00 of the 2003-04 Budget Act to make General Fund backfill payments to local governments for the remainder of Fiscal Year 2003-04 and to use the General Fund to pay VLF refunds to taxpayers who had paid the higher rate (otherwise refunds would be deducted from VLF revenue distributions to local governments). The director's letter contended that the Legislature's budget action to suspend backfill payments in 2003-04 was not intended to reduce funding to local governments (except for the gap loan) since local governments were expected to receive their full VLF revenues from taxpayers. The director asserted that the backfill suspension no longer applied because Governor Schwarzenegger's action to reduce the VLF would otherwise result in a shortfall in local government funding and constitute "a situation of extreme peril that threatens the health and safety of persons and property." She did not propose to backfill local governments' revenue loss during the gap period prior to October 1. However, she indicated that the estimated gap amount had grown to \$1.3 billion (to be repaid in 2006-07). Finally, the director also implemented \$148.8 million of spending reductions in various departments and programs (the majority in Higher Education) citing the authority provided by Section 27.00 to reduce appropriations by up to 5 percent in order to offset deficiency costs.

- ◆ **Inappropriate Use of Deficiency Authority.** On December 23rd, Senator Chesbro, as Chair of the Joint Legislative Budget Committee, objected to the Director of Finance's actions and stated that they represented "both a flagrant misuse of Section 27.00 and a serious infringement of legislative powers." However, the Controller has been making backfill payments under the administration's direction. A legal challenge to the backfill expenditures and to the spending reductions that were implemented under the asserted deficiency authority was filed with the California Supreme Court on January 22, 2004 (*University of California Students Association v. Schwarzenegger*).

■ MAJOR PROVISIONS

The major provisions for the Governor's Budget for VLF backfill include:

The 2004-05 Governor's Budget includes the following General Fund expenditures for VLF backfill payments to local governments (including amounts for taxpayer refunds):

- ◆ **\$2.7 billion in 2003-04.** This amount consists of \$2.652 billion for post-October 1 backfill payments and refunds (pursuant to the Section 27.00 determination discussed above) and \$51 million that the administration is requesting the Legislature appropriate to fund hardship allocations of backfill for the VLF gap period (an increase of \$11 million over the \$40 million authorization in AB 1768).
- ◆ **\$4.1 billion in 2004-05.** This is the estimated amount of backfill payments to fully fund VLF offsets in 2004-05, and will be paid under existing continuous appropriation authority.

Additional Property Tax Shift

The Governor's Budget assumes \$1.3 billion of General Fund savings in 2004-05 from a proposed ongoing annual increase in the property tax shift from local governments to schools and community colleges. This shift takes place via the Educational Revenue Augmentation Fund (ERAF) in each county and reduces on a dollar-for-dollar basis the state's General Fund obligation to K-14 education under Proposition 98. The administration indicates that this proposal is intended as a permanent ongoing equivalent to the \$1.3 billion of VLF gap funding shortfall to local government in the current year. However, this additional ERAF shift will not be repaid to local governments, and the impact will fall more heavily on counties and less heavily on cities, compared with the VLF gap impacts. Moreover, the additional ERAF shift would redirect \$135 million from redevelopment agencies and \$105 million from special districts, neither of which receive VLF funding. This proposal requires budget trailer legislation.

■ **ADDITIONAL HIGHLIGHTS**

Additional Highlights of the proposed Local Government Budget:

- ◆ **Elimination of Booking Fee Subventions.** \$38.2 million General Fund savings from eliminating Booking Fee Subventions to certain cities and special districts. These subventions equal the amount each of these entities paid in 1999 to counties as fees for booking suspects. In addition, the Governor's budget proposes legislation to eliminate counties' authority to charge booking fees (as in pending legislation--AB 1749, (Committee on Budget). The impact on counties could be more or less than \$38.2 million depending on how much booking fees have changed since 1999. (Item 9210—Local Government Financing)
- ◆ **Suspension of Proposition 42.** \$179 million General Fund savings from suspension of Proposition 42 local transportation funding allocations (discussed in the Transportation section of this review).
- ◆ **Shared Revenues.** \$11.9 million General Fund savings in 2004-05 (Item 9350 - Shared Revenues) from enactment of legislation to eliminate the remaining Realignment portion of the VLF backfill for International Registration Plan Trailers (\$5.9 million 2003-04 savings was included in the Mid-Year reductions).
- ◆ **Continued Deferral of Mandate Reimbursements.** Consistent with legislative intent expressed in the Fiscal Year 2003-04 Budget Package, the Governor's Budget continues to defer reimbursements to local governments for the cost of carrying out state-mandated programs or activities. The budget also proposes repeal of eight mandates that have been suspended for a number of years. The Legislative Analyst estimates that the backlog of unpaid mandate reimbursements will total over \$1 billion by the end of Fiscal Year 2004-05.
- ◆ **COPS/Juvenile Justice Funding Continued.** The Governor's Budget proposes \$200 million (General Fund) to be evenly divided between the Citizens' Option for Public Safety (COPS) and Schiff-Cardenas Juvenile Justice Grants. This continues the level of funding in 2003-04. The COPS program provides resources to local law enforcement agencies for "frontline" law enforcement purposes, jail operations and district attorney operations. Juvenile justice grants implement juvenile justice action strategies developed at the local level intended to provide a continuum of responses to juvenile crime and delinquency. (Item 9210—Local Government Financing)