

GOVERNOR'S 1999-00 BUDGET PROPOSAL FOR: LOCAL GOVERNMENT

In the 20 years since the passage of Proposition 13 in 1978, California has endured various changes in the fiscal relationship between state and local government. These changes have occurred via statute, ballot initiative and/or court decision. In addition, local government revenues have been affected due to a lackluster economy, state actions to capture local revenues, and the enactment of various measures.

Perhaps the most significant State action affecting local government finance since the State's bailed out local governments in the aftermath of the passage of Proposition 13 has been the shift of property tax dollars to the State as part of the Educational Revenue Augmentation Fund (ERAF) shift. The ERAF shift results from the budget shortfalls the State faced in the early 1990's, and is expected to be approximately \$3.75 billion in 1999-00. The ERAF shift has been offset somewhat by the passage of Proposition 172, which provided a ½ cent sales tax for local governments, trial court funding restructuring that has shifted much of the funding responsibilities to the State, the Citizens' Option for Public Safety (COPS) program, which provides local governments funding for law enforcement needs, and the historic tobacco litigation settlement which will provide general purpose dollars to local governments.

MAJOR PROPOSALS

The major proposals for Local Government Finance include:

- \$100 million for the Citizens' Option for Public Safety (COPS) program and make the program permanent through Legislation. This permanent funding will be available only to hire local law enforcement personnel or for law enforcement related equipment if matching funds are provided.
- Continued funding of the State buyout of court costs for the 20 smallest counties and \$48 million to reduce the next 18 smallest counties' court costs by 50 percent and the remaining 20 counties' court costs by five percent. Due to reductions in revenue projections, the budget is unable to completely buyout the court costs of all 38 smallest counties and to reduce the court costs of the remaining 20 counties by 10 percent - per legislation passed in 1998. Never the less, the State's share of local court costs has increased from less than 30 percent a decade ago to 67 percent in 1989-99, and to 72 percent in 1999-00.
- Recognizing that local governments will receive approximately \$550 million per year for 25 years as a result of the landmark tobacco litigation settlement and up to \$130 million per year from the recently enacted Proposition 10 cigarette tax which will be allocated at the discretion of county commissions.

New Relationship between the State and Local Government: The Governor proposes a new relationship between the State and local governments based upon the principle of sharing benefits and risks. The Governor's budget reflects this principle. For example, the economy promises to remain strong, and the budget proposes to share this benefit by making permanent the \$100 million COPS program. However, current projected revenues for the budget year have fallen off since earlier projections. The budget proposes to share this risk – rather than having it all fall on either the State or local governments – by containing \$48 million rather than \$96 million for the trial court funding restructuring agreement approved in 1998.

To further develop a clear policy of shared risks and benefits, the Administration proposes comprehensive discussions with elected local officials and interested citizens. Prior to spring, the Office of Planning and Research will make recommendations on the proper method and forum for such discussion.

The Educational Revenue Augmentation Fund: In 1992-93 and 1993-94, the state shifted property taxes otherwise due to counties, cities, and special districts to the ERAF to reduce the state's General Fund obligation to local school districts. This reduction in local property tax revenues occurred at the same time the recession was adversely impacting other local revenues, and the costs to counties for providing health and welfare services were increasing. This situation was compounded by local agencies being limited by the constitution and statutes from imposing or increasing most taxes and many fees to replace these lost revenues. In essence, the ERAF shift reversed the bailout the State provided local governments in 1978 and 1979 as a result of the passage of Proposition 13.

For 1999-00 the ERAF shift will be approximately \$3.75 billion. The contributions come from counties (\$2.854 billion), cities (\$585 million), and special districts (\$311 million). Several factors lessen the impact of the ERAF shift to local governments. These include:

- \$1.954 billion from the ½ cent sales tax authorized by Proposition 172, which was passed by voters in 1993. Proposition 172 was enacted to assist local governments meet public safety needs that were jeopardized by the ERAF shift.
- \$418 million from trial court funding restructuring for local government relief. This includes \$350 million resulting from the reforms approved in 1997 (\$288 million to back-fill for county contribution and \$62 million to back-fill fine and penalty revenue previously remitted to the state from cities), \$48 million resulting from a revised version of reforms approved in 1998, and \$20 million resulting from the State now being responsible for salary increases of court employees.

- \$100 million for the Citizen's Option for Public Safety (COPS) program. The Governor's budget proposes that COPS become a permanent program, rather than sunsetting on June 30, 2000. The proposed permanent program would provide local governments the opportunity to hire additional law enforcement officers, without having to commit additional general purpose dollars.
- \$560 million from the tobacco litigation settlement. The central claim against the tobacco industry was that the State was forced to spend billions of General Fund dollars treating tobacco related diseases. The settlement amount for counties relates to the ERAF shift because tobacco related diseases strained the General Fund and in part necessitated the shift of funds from local governments for education funding.

The Administration suggests that a thorough accounting of the ERAF shift and its offsets is needed to identify the level of mitigation needed to make local governments whole. There are a number of potential mitigation mechanisms should the need for additional ERAF relief be identified. These include:

- **Baseline Reduction:** The amounts shifted to the State in fiscal years 1992-93 and 1993-94 is defined as the "base" amounts shifted to ERAF from counties. This option would incrementally reduce the original amount transferred over a number of years until the entire base is no longer shifted to schools. Under this option, returned property tax revenues would be in proportion of the amount originally shifted instead of being dependent on growth in a county's assessed valuation. The fiscal impact of this proposal would be contingent upon the agreed upon reduction or percent.
- **Freeze the Shift at the FY 1998-99 Levels:** This approach would freeze the amount of property taxes local government contributes to ERAF at the 1998-99 fiscal year levels. The amount of property tax revenues realized under the "freeze" option is contingent upon increases in assessed property values for each county. It is estimated this option would enable local governments to keep approximately \$130 million in property tax growth (assumes 3.5 to 4 percent growth statewide)
- **Repeal ERAF:** This option would eliminate the entire shift altogether which would equal the entire original shift, and all increase in property tax revenues from each county's assessed valuation growth since FY 1994-95.

Trial Court Funding: The Governor's budget proposes to continue funding the Trial Court Funding Act of 1997, which provides \$350 million in relief to local governments in 1999-00. In addition, the budget provides \$48 million in relief by revising the trial court funding restructure contained in legislation enacted in 1998.

Under the Governor's budget, the State will provide 72 percent of trial court expenditures for 1999-00. This is up from 62 percent in the current year. Since 1990-91, the State's share of trial court funding has grown from 31 percent of total expenditures.

For 1999-00 funding for trial courts is as follows:

- 20 smallest counties: The State buys-out all court costs;
- Next 18 smallest counties: The State pays all court costs above 1994-95 levels and 50 percent of the 1994-95 levels; and
- 20 largest counties: The State pays all court costs above 1994-95 levels and five percent of the 1994-95 levels.

Other key aspects of trial court funding include providing \$20 million for salary increases of court employees and \$10 million for the Judicial Administration Efficiency and Modernization Fund for courts to address pressing information technology needs.

Citizens' Option for Public Safety: The Governor proposes to make the \$100 million for the COPS program permanent. Funding for COPS was first provided in the 1997-98 State Budget Act and was scheduled to sunset on June 30, 2000. Without the guarantee of permanent funds, local governments were reluctant to commit COPS funds to long-term needs. Under the Governor's proposal, the funds are to be used for the specific long-term need of putting additional law enforcement officers on the streets. Local governments could also use the funds for law enforcement equipment, but only if matching funds are provided.

Currently, COPS funds are allocated as follows: \$75 million for distribution among counties for front line law enforcement services; \$12.5 million for county sheriffs for the operation of local jails; and \$12.5 million for district attorneys. The proposal for 1999-00 allocates all COPS funds for hiring officers or purchasing equipment, as specified above.