SELECTED ISSUES: THE 1998-99 BUDGET PROPOSAL FOR: LOCAL GOVERNMENT

MAJOR PROPOSALS

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. During the past ten years, local governments have been faced with an erosion of local revenues due to a lackluster economy, state actions to capture local revenues, and the enactment of various measures. These factors have all contributed in limiting the ability of local agencies to impose or increase resources through additional taxes, assessments, and/or fees. Meanwhile, counties increasingly have had to bear more fiscal responsibility for health and welfare, and infrastructure programs, while the state requires cities to pay a larger share of certain county costs, like those associated with property tax administration costs.

Most of the 58 counties and thousands of cities and special districts face budget shortfalls because local property tax dollars are indirectly being used to balance the state budget. Specifically, California's local governments continue to transfer approximately $2.6 billion annually in property taxes to the state. This amount increases as property values in each county escalate. Consequently, California local governments have had to implement various cost saving measures, some of which directly impact the services received by the public, e.g. furlough days and days of local government office closures. Local governments continually are faced with further reductions in existing programs due to the decrease in discretionary dollars.

Local discretionary dollars provide services in program areas such as libraries, parks and recreation, capital improvements, ongoing maintenance, property tax and fiscal systems, and agriculture. These programs are vital in determining the "quality of life" available in each county, and are a critical part of a county's ability to attract and retain business. Businesses expect to locate in communities with an adequate physical infrastructure and adequate resources for health and public safety programs, as well as the recreational needs of its employees.

Although the State's economy is projected to be prosperous, the Governor's budget does little to address the ongoing fiscal problems faced by local governments. Specifically, it does not provide any significant proposals to provide relief or return revenues to local governments and special districts. However, the budget does reflect two major proposals the Legislature was instrumental in developing last year's which benefit the people of California--the California Work Opportunity and Responsibility to Kids (CalWORKs) program and the Trial Court Funding Act of 1997. These programs contain local flexibility and fiscal incentives, which represent a significant step in a better State/local partnership.

LOCAL REVENUE SOURCES

Local revenues are made up in part from taxes administered by the state, or where state law sets the tax base. The Governor's budget contains revenue projections for these local tax sources.

The property tax, which has been growing at a much slower rate over the last few years than it did in the late 1980s, is projected to increase to $20.6 billion in 1998-99. This represents a five percent, or approximately $1.0 billion increase over revised 1997-98 estimates. This will be the highest growth rate since 1992-93. The Governor's budget reflects these property taxes to be distributed as follows in Table 1:

Table 1

PROPERTY TAX DISTRIBUTION

Recipients	Percentage Split
K – 14 Schools	53
Counties	20
Cities	11
Redevelopment Agencies	8
Other Special Districts	8
TOTAL	**100**

California's state and local sales tax rates range from 7.25 percent to a maximum of 8.5 percent. Table 2 provides a break-down of the applicable statewide local revenue base rates:

Table 2

STATE AND LOCAL SALES AND USE TAX RATES

Taxes	% Tax Rate	Description of Tax Use
STATE RATES		
General Fund	5.00	Rate can be reduced under specified conditions.
Local Revenue Fund	0.50	For local governments to fund health programs.
LOCAL UNIFORM RATES		
Bradley-Burns	1.00	Per city & county ordinance for general purposes.
Transportation Rate	0.25	For county transportation purposes.
Local Public Safety Fund	0.50	For counties for public safety purposes (Prop. 172).
LOCAL ADD-ON RATES		
Transactions & Use Taxes	1.50	Optional at county discretion (1.50% is max).
TOTAL	**8.75**	

Sales tax revenues are expected to increase by $0.9 billion, or 4.6 percent over revised 1997-98 estimates in 1998-99 to a total of $20.4 billion.

The 1991-92 realignment legislation transferred to counties all previous state responsibility for mental health service delivery, public health programs and indigent care. In addition, a number of state/county sharing ratios for other health and social services programs were changed making counties more accountable in program outcomes. To offset these costs, the counties received roughly $2 billion in increased sales tax and vehicle license fee allotments.

The vehicle license fee (VLF) is imposed in lieu of a local personal property tax on automobiles and is administered by the Department of Motor Vehicles (DMV). All of the revenues from this tax, other than administrative costs and fees on trailer coaches and mobilehomes, are constitutionally dedicated to local governments.

The VLF is calculated on the vehicle's "market value" which is the cost to the purchaser exclusive of sales tax adjusted by a specified depreciation schedule. A two-percent rate is applied to the depreciated value to determine the fee. Consequently, this revenue contingent upon the number of vehicles in the State, the ages of those vehicles, and their most recent sales prices.

In fiscal year 1997-98, local governments received over $3.7 billion in VLF revenues. The VLF is the third highest revenue source for cities, behind real property and sales taxes. The VLF is the second highest revenue source for counties, behind real property taxes. Most of these funds are allocated on a per capita basis. However, a quarter of all VLF revenues that local governments receive go toward mental health programs.

THE EDUCATIONAL REVENUE AUGMENTATION FUND

In accordance with Article XIIIA of the State Constitution (Proposition 13), property is assessed at its 1975 fair market value until the property changes ownership. Once the property is sold, the assessed value of the property is redetermined based on current market value. The fair market value of new construction is determined upon completion, and is not reassessed until there is a change in ownership. The value initially established in 1975, or subsequently reestablished after a sale, is referred to as the "base year value." The “base year value” may be annually increased by an inflation factor, not to exceed two percent.

The State Constitution also limits the property tax rate to one percent plus an amount for debt approved by the voters prior to June 1978.

Following the enactment of Proposition 13, the Legislature enacted AB 8 (Greene) Chapter 282, Statues of 1979, which provided a method of allocating the proceeds from the 1 percent property tax rate. The property tax allocation formulas established by AB 8 ensured that in any fiscal year, a local government received property tax revenues in an amount equal to what it received in the prior fiscal year (i.e. “base”) and its share of the growth in the assessed value within its boundaries. AB 8, among other things, also: (1) authorized permanent shift of a sizable portion of the property tax base from school districts to cities, counties, and special districts (2) provided state “buyout” of certain county health and welfare program costs which had previously been financed with the property tax, and (3) increased the commitment of state revenues to replace much of the school property taxes base lost.

In 1992-93 and 1993-94, subsequent to the above noted changes in property tax allocation formulas, the state shifted $3.6 billion from the property taxes otherwise due to counties, cities, and special districts to the Educational Revenue Augmentation Fund (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 was 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. The passage of Proposition 218 in November 1996 further limited the ability of local agencies to impose or increase taxes, assessments, and/or fees without a vote of the people.

About half of these county funds were replaced by the passage of the Proposition 172 Public Safety Sales Tax, but those funds can only be used for public safety. This means that the net loss to counties of $1.3 billion per year is magnified by the fact the lost property tax dollars were "discretionary" while the replacement dollars were not. Legislation implementing Proposition 172 added a final complication because it contained a maintenance-of-effort which required counties to maintain prior funding of public safety programs. It is important to note that property tax revenue serves as the primary source of "discretionary" dollars for counties, and the lack of reasonable amounts of discretionary funds hinders the ability of counties to provide needed local services.

The property tax shift has resulted in a reduced ability of local agencies to provide the infrastructure and services needed for both residential and business development. Retail development is the one exception because the business development produces sufficient revenues through sales tax to support necessary public services. This aggravates an already existing incentive for counties and cities to engage in “cash box” land use decisions, i.e. those which generate the most local revenue and not necessarily in the best interest of the community. In reaction to declining shares of property tax revenues coupled with deep cuts in discretionary programs, counties are required to focus on increasing sales and use tax revenues to remain solvent. Consequently, local governments are compelled to make economic development decisions which lean more toward sales tax production instead of a more balanced approach to development which includes manufacturing and residential construction. The focus on sales tax revenue can ultimately lead to destructive competition among local governments without any net increase in any overall economic activity.

Counties are responsible for administering the property tax system, but with reduced discretionary revenues, this program area has been significantly reduced. Under current law, the State does not pay any of the administration costs associated with the property tax system, even though it receives 54 percent of the revenues via the schools. All other governments receiving property taxes pay a proportionate share of administrative costs. Consequently, counties pay 74 percent of the administration costs, yet only receive 20 percent of the proceeds. This inequity provides no incentive for counties to invest in the property tax administration system. Failure to adequately maintain this system reduces revenues for all local agencies and the State

Last year, the Governor and the Legislature offered several budget proposals to deal with the return of property taxes to local governments. These included a proposal by the Governor to return $100 million to local governments, a $280 million proposal in the Assembly Budget, and a $280 million proposal by the Assembly Local Government Caucus. Apart from partially returning monies to local governments, there are numerous other proposals that would have returned ERAF funds to local governments. The three most commonly discussed options for reversing the property tax shift to ERAF are as follows:

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 1996-97 Levels: This approach would freeze the amount of property taxes local government contributes to ERAF at the 1996-97 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. Last year, the Legislative Analyst's Office estimated that under this options local governments would benefit by keeping 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.

It is recognized that the property tax shift from local agencies to schools was imposed at a time when the state had to look at all available resources to balance the budget. Major cuts were made to K-12 schools, and taxes were increased. However, since 1993-94 the state has been in a much stronger fiscal situation. In fact, many of the major cuts made in past years have at least been partially restored, i.e. the state is in the process of fully repaying the deficit in Proposition 98 expenditures, and the PERS loan taken during that period has fully been repaid.

PROPOSITION 218

Proposition 218 was approved by the voters in November, of 1996. This measure requires a vote of the people for local agencies to impose taxes, assessments, and some fees. The Governor's proposed budget continues to be silent on this issue, and on how the limitation of local governments to raise revenues will interact with any responsibilities under federal welfare reform now that a welfare plan is being implemented.

Proposition 218 sets up a new process for special assessments allowing them to be repealed by initiative, a new mail ballot process, and a change in the burden of proof in legal actions contesting the validity of an assessment. In addition, this Proposition imposes extensive hearing requirements for new or increased property-related fees, a "majority protest" procedure for rejecting fees, and a majority vote requirement for some property related fees. Proposition 218 prohibits use of property related fees for general governmental services.

WELFARE REFORM

Implementation of federal welfare reform, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, will have a significant fiscal impact on local governments as they revamp their existing social services programs. CalWORKs implements California's version of the federal Temporary Assistance for Needy Families (TANF) program (for more details on CalWORKS see Social Services Section).

The State's has set, via CalWORKs, basic program standards including grant levels, eligibility criteria and time limits. Individual counties will receive a block grant for administration of their respective program. This is not an open-ended entitlement, but can be used for a variety of purposes such as employment services, child care, supportive services and administration. This will provide counties with some flexibility to design programs suited to their individual needs. Although provided with broad discretion, counties are required to maintain their 1996-97 spending levels for those same services to ensure that counties contribute toward the state/county TANF maintenance of effort (MOE) requirement.

Additionally, the Governor's budget proposes: (1) $167.4 million from federal Temporary Assistance for Needy Families (TANF) funds for the Comprehensive Youth Services Act. This is an increase of $26.5 million, or 18.8 percent, over 1997-98. Counties may use these funds for a wide range of services including gang intervention, substance abuse prevention and counseling, and (2) $33 million in TANF funds for county camps and ranches.

TRIAL COURT FUNDING

The 1997-98 Governor's budget contained a proposal to consolidate the funding responsibility for the trial courts at the State level. In enacting the 1997 Budget Act, the Legislature enacted a modified version of the Governor's plan, in Assembly Bill 233 (Escutia), Chapter 850, Statutes of 1997.

The revised restructuring plan will result in a major change in the method by which funding is provided to trial courts, and will provide needed relief to counties this year. Specifically, beginning in 1997-98, funding for the trial courts (except for costs associated with facilities, local judicial benefits, and revenue collection) will be consolidated at the state level. The county contribution for both General Fund and fine and penalty amounts will be capped at the 1994-95 level. The state will be responsible for future growth in trial court costs, including workload increases, inflation adjustments, and any new programs. It is estimated that these cost increases could be $30 million to $80 million annually. However, because future costs will now become a State General Fund obligation, these costs will be reviewed by the State (particularly the Judicial Council) which, until now, were largely controlled by counties and the courts themselves.

This instrumental restructuring plan provides a clear, stable and consistent source of funding for trial courts throughout the state. Consequently, it will increase flexibility and accountability for management of the courts, thereby ensuring efficient and effective court operations. In addition, since funding will not be contingent upon the financial stability of individual counties, funding for the statewide justice system should be distributed more equitably.

AB 233 also created two task forces to review and make recommendations on two significant areas regarding the change in state and local responsibility for funding the courts. The first is related to the future personnel structure of the trial courts, including studying whether trial court personnel should be court employees, state employees, or continue as county employees. The second is related to future funding responsibility for court facilities, which are the obligation of the counties under AB 233.

The Governor's budget reflects various proposals approved last year through the Legislative process (AB 233 and AB 1438, both by Assemblywoman Escutia) for trial court restructuring. Although the effective date of these statutes is January 1, 1998, the majority of the provisions that offer fiscal relief to counties will not be effective until July 1, 1998. Nevertheless, the budget includes, among other things, the following major proposals which if enacted will bring total funding for trial courts in 1998-99 to approximately $1.75 billion:

- $350 million to back-fill contributions previously forwarded from counties to the State's General Fund. Specifically: (1) $288 million to back-fill for county contributions, including $10.7 million to buy out the county contribution in the 20 smallest counties; and (2) $62 million to back-fill fine and penalty revenue previously remitted to the state from cities;

- $50 million for the Judicial Administration Efficiency and Modernization Fund authorized by AB 233. This fund will be used to promote improved access, efficiency and effectiveness in trial courts that have been unified to the fullest extent allowed by law;

- $50 million for court security and workload growth; and

- $13.2 million to provide funding for 40 judgeships on a phased-in basis authorized by AB 420 (Baca), Chapter 858 of 1997.

CITIZENS' OPTION FOR PUBLIC SAFETY

Consistent with the agreement reached with the Legislature during 1997 Budget Act negotiations to fund this for an additional three-years, the Governor's budget proposes to continue the Citizens' for Public Safety (COPS) program with $100 million for front-line public safety activities. Funding for COPS was originally authorized in 1996-97 on a one-time basis. Consistent with prior years, the funds are proposed to be allocated pursuant to the existing formula. District attorneys would receive $12.5 million and county sheriffs will receive $12.5 million for the operation of local jails. The remaining $75 million would be distributed to cities and counties based on population for front line law enforcement services. It is proposed that the funds for cities and counties be used solely for front-line law enforcement and that they supplement and not supplant existing funding.