

SMART Task Force

Report



**Kathleen Connell
California State Controller**

August 1999

Contents

Controller’s Message	2
Summary of Recommendations	4
New Local Financing Formula	4
Funding of Local Mandates	14
Government Accountability	15
Implementation	16
Perspectives of Stakeholders	17
Building a Foundation for the Future	18
Historical Perspective	18
Tax Policy	23
Intergovernmental Accountability	28
Land Use Planning	32
Appendices	
A. Percentage of Local Revenues and Expenditures for California Cities and Counties (1993–1997)	37
B. Education Revenue Augmentation Fund (ERAF) Shift (1992/1993 – 1998/1999)	38
C. Notes to Alternative Plans and the “SMART Formula”	39

Controller's Message

Today we stand on the threshold of the 21st century and all Californians share unbridled optimism that our great State will expand its role as the intellectual and economic capital of this exciting new age. As California's Chief Financial Officer, I am concerned that we may sabotage this future unless we confront directly the current imbalance between State and local finances and forge a consensus that will return fairness to statewide revenue allocation. We must allow our cities and counties to rebuild from the neglect of the past years and prepare for the new century.

Over the past decade, local government has not been able to provide the quality and level of services that our citizens have a right to expect because the State government — unwilling to raise taxes or cut services — has resolved its own budget problems by expropriating property taxes, long the primary revenue resource for local government.

California's remarkable economic surge over the past three years presented an opportunity for the State to reverse the annual flow of property tax diversions back to the local level. Instead, it captured almost \$3.6 billion in property taxes in fiscal year 1998-1999, celebrated a \$4.3 billion surplus and planned its budget accordingly.

With the State experiencing unparalleled economic growth and budget surpluses, the timing could not be better for addressing what I increasingly believe is the most crucial public policy issue facing our State and its future. If we wait until the

next inevitable downturn, it will be too late to identify — much less implement — any truly innovative strategies.

Thus, in February 1999, I formed the State Municipal Advisory Reform Team (SMART). The SMART Task Force was comprised of distinguished representatives of State and local government, business and labor, environmentalists, real estate developers, and economists. I charged the Task Force members with finding an equitable solution that would assure a stable, predictable revenue stream to local government without jeopardizing existing obligations and without raising taxes. I asked them to be creative, pragmatic and visionary. And they were.

Their first key decision was to focus on three distinct areas in which State government actions have skewed local policy decisions and hampered the ability of local governments to address their citizens' needs. These are tax policy, intergovernmental accountability and land use planning.

Following six months of study, meetings and debate, the Task Force settled on three primary recommendations that redefine intergovernmental financing relationships:

Recommendation 1: Restructure State and Local Property and Sales Taxes

The Task Force engaged in exhaustive economic analysis to test the fiscal impacts of an innovative approach to place a "cap" on the State's diversion of property taxes revenues and apportion future local sales taxes on

factors independent of point-of-sale considerations. This analysis confirmed that a carefully structured formula, if implemented, will:

- Generate approximately \$4.5 billion in additional revenue for local government over a 10-year period;
- Make a baseline reduction in ERAF property tax diversions to \$3.2 billion to assist the State in funding its educational obligations;
- Reduce the retail fiscalization of land use at the local level by eliminating the tax incentives for poor local planning decisions. Sales tax will continue as a source of repayment for existing redevelopment commitments by local governments and special districts; and
- **REQUIRE NO NEW STATE OR LOCAL TAXES AND NO MODIFICATIONS OF PROPOSITION 13.**

The Task Force's sales tax re-allocation proposal could also be unilaterally enacted with a State financial commitment of \$31 million based on Fiscal Year 1997-1998 sales tax revenues, an extremely moderate sum in light of the current \$4.3 billion State surplus. However, if the State does not equalize sales taxes and guarantee a minimum \$150 million in local assistance, a "hard cap" on ERAF should be considered. For that minimal investment, all of the countywide allocation inequities could be offset and retail fiscalization would become a non-issue in future local planning decisions.

The Task Force also strongly recommended that the State establish a prudent reserve for economic downturns and require performance budgeting of State programs as a way to fund those reserves.

***Recommendation 2:
Eliminate "Unfunded" State Mandates to Municipalities***

The Task Force was convinced that the State should be required to accurately disclose and fully fund the cost of any new law, regulation or executive order that requires implementation by local governments.

***Recommendation 3:
Improve Efficiency and Effectiveness of Government Programs***

The Task Force insisted that all State programs administered by local agencies should incorporate a mutual compact listing the respective obligations and responsibilities of the State and localities and integrating State funded performance based budgeting and performance auditing.

The SMART Task Force has provided us with an innovative blueprint. The current economic prosperity in California will smooth the way for a relatively painless restructuring of State and local finances. Now we need only the political will to act. By releasing this report as the California State Legislature reconvenes in August 1999, the SMART Task Force urges the Legislature to make this issue a top priority.

Let us usher in the millennium with bold decisions that establish a solid financial infrastructure for all levels of California's governments and set the stage for a new Golden Era for the Golden State in the 21st century!

Kathleen Connell
California State Controller

Summary of Recommendations

New Local Financing Formula

Discussion of Objectives

For local governments to regain their fiscal health, two major structural changes must occur:

- Local governments must have a source of secure, stable, and sufficient revenues to meet local needs, independent of State control or intervention; and
- Local governments and services mandated by the State must be accompanied by funding that is sufficient to support them.

The Task Force quickly concluded that the current scheme of State and local taxation in California has been dominated by two serious problems:

- The growing diversions of property tax revenues by the State through its Educational Revenue Augmentation Funds (ERAFs) has critically short-changed cash starved local governments; and
- The distribution of the local component of the sales tax based upon point-of-sale has distorted local planning decisions by creating financial incentives for local governments to promote retail outlets that generate high volume sales at the expense of housing and businesses that create well-paying jobs. This is more commonly known as “retail fiscalization.”

To address these problems, the Task Force agreed that a major readjustment in the collection and reallocation of sales taxes and property taxes is needed. This proposal to end the distribution of

local sales taxes on the basis of point-of-sale will begin the transition towards distribution of revenue on the basis of population. The Task Force identified multiple proposed solutions to redistribute sales tax and property tax revenues that could conceptually fulfill both objectives and then quantified the impact of each alternative formula on California’s local governments.

Review of Alternative Plans

The Task Force readily concedes that the identification of these problems was not novel. Virtually every one of the groups and research organizations that have studied, and are studying California’s current tax structure, have identified the same problems.

Likewise, all of these groups and organizations have recommended the adoption of some form of tax redistribution targeted to accomplish three objectives:

1. Increase discretionary income for local government without unduly impacting State government or increasing taxes;
2. Redistribute sales tax revenues among local governments in a manner that would be proportional to public need; and
3. Encourage balanced planning decisions in the future while not punishing local government for past planning decisions that were predicated on “point-of-sale” reimbursement.

The challenge was to create a solution that was economically fair across the board and capable of achieving approval from a broad political consensus. This is the point at which the SMART Task Force and the other groups and organi-

zations diverged. This caused the Task Force’s predecessors to suggest only general concepts and approaches without any fixed formulas that could be tested against real-life economic scenarios.

However, the two most common approaches — a Statewide property tax/sales tax “swap” and a sales tax allocated by statewide population have serious consequences on local government when actually implemented. These formulas do not result in an equitable flow of revenues to cities and counties.

Alternative One - Property Tax Swap

Some commentators have suggested a revenue neutral exchange of the state-controlled ERAF property taxes for local sales taxes under the generic description of “tax swap”. The common claim of the “tax swap” supporters is that such a direct exchange statewide would create local incentives for better land use planning and an end to fiscalization.

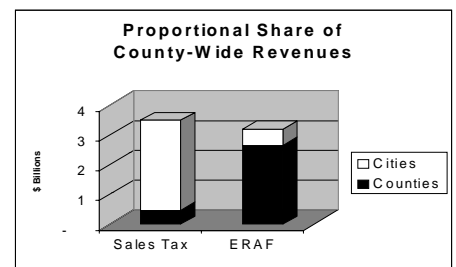
The Task Force discovered that there can never be a truly dollar-for-dollar “swap” of ERAF property taxes and local sales taxes because local sales tax revenues are substantially greater. Even if the State attempted to exchange every ERAF dollar for identical sales tax dollars in each county, an excess of \$500 million in local taxes would continue to be generated on a “point-of-sale” basis and therefore prolong retail fiscalization.

Creative local elected leaders will continue to engage in furious competition for business that generate retail sales so long as the opportunity exists to enhance local tax revenues. Even if the incentives are reduced by some factor,

the lack of any other politically “painless” method of increasing revenues means that any marginal tax benefits from “point of sale” will sustain retail fiscalization

Poor planning decisions that discriminate against housing and higher income industries are the natural political by-products of tax revenue inducements caused by the “point of sale” distribution.

Although specifically not quantified in the Task Force report, the “swap” would also cause serious disruptions at the city level because the vast majority of local sales taxes, particularly in the high growth urban counties, are dedicated city revenue. For example in fiscal year 1996-1997, the cities of San Jose and Santa Clara combined received over \$86 million more in sales taxes than in total property taxes. To effect a “swap” in Santa Clara County, its cities would be most impacted by the loss of sales taxes while its county government would be the favored recipient of the returning property taxes (see chart below). As a result, most of the major metropolitan areas would drown in a tide of red ink.



Finally for the State to equalize for those countywide areas that would sustain a loss due to the “swap,” the State would be required to backfill \$252 million to the 15 impacted counties. To be compatible with the

Alternative Plan 1 — Impact of Swapping Sales Taxes with the Educational Revenue Augmentation Fund (ERAF) Property Tax (Amounts in Thousands)

	SMART Formula Equalization							
	Estimated County and Cities ERAF Property Tax Contributions	Current County and Cities Sales Taxes	Total Maximum Swap of the Lesser of Estimated ERAF Property Tax Contributions or Sales Taxes for County and Cities	Excess ERAF Property Tax Contributions over Sales Taxes remaining with State	Total Swap plus Excess ERAF remaining with State	Excess Sales Taxes remaining County-wide	\$450 Million State Supplement Distributed based on ERAF Contributions	Net After Receipt of \$450 Million State Supplement
Alameda	190,905	191,173	190,905		190,905	268	26,990	26,990
Alpine	153	289	153		153	136	22	22
Amador	2,297	2,792	2,297		2,297	495	325	325
Butte	8,863	16,506	8,863		8,863	7,643	1,253	1,253
Calaveras	2,881	1,917	1,917	964	2,881		407	1,372
Colusa	1,699	1,920	1,699		1,699	221	240	240
Contra Costa	102,345	96,275	96,275	6,070	102,345		14,469	20,540
Del Norte	1,226	1,511	1,226		1,226	285	173	173
El Dorado	10,500	10,490	10,490	10	10,500		1,485	1,495
Fresno	65,197	69,651	65,197		65,197	4,454	9,218	9,218
Glenn	1,997	1,895	1,895	102	1,997		282	384
Humboldt	10,847	11,127	10,847		10,847	280	1,534	1,534
Imperial	6,904	10,768	6,904		6,904	3,864	976	976
Inyo	1,768	2,169	1,768		1,768	401	250	250
Kern	46,966	57,805	46,966		46,966	10,839	6,640	6,640
Kings	8,606	7,492	7,492	1,114	8,606		1,217	2,331
Lake	3,995	3,245	3,245	749	3,995		565	1,314
Lassen	1,208	1,834	1,208		1,208	626	171	171
Los Angeles	1,081,013	881,047	881,047	199,966	1,081,013		152,833	352,800
Madera	7,233	7,251	7,233		7,233	18	1,023	1,023
Marin	29,435	32,017	29,435		29,435	2,582	4,162	4,162
Mariposa	875	1,235	875		875	361	124	124
Mendocino	6,684	8,111	6,684		6,684	1,428	945	945
Merced	16,295	13,838	13,838	2,457	16,295		2,304	4,761
Modoc	681	584	584	97	681		96	193
Mono	1,580	1,535	1,535	45	1,580		223	268
Monterey	28,760	37,390	28,760		28,760	8,630	4,066	4,066
Napa	12,477	12,588	12,477		12,477	111	1,764	1,764
Nevada	7,400	7,776	7,400		7,400	376	1,046	1,046
Orange	208,161	360,558	208,161		208,161	152,396	29,430	29,430
Placer	20,890	31,503	20,890		20,890	10,613	2,953	2,953
Plumas	1,181	1,664	1,181		1,181	483	167	167
Riverside	88,668	123,351	88,668		88,668	34,684	12,536	12,536
Sacramento	113,619	129,258	113,619		113,619	15,639	16,063	16,063
San Benito	2,287	3,631	2,287		2,287	1,344	323	323
San Bernardino	126,219	144,524	126,219		126,219	18,306	17,845	17,845
San Diego	191,889	284,166	191,889		191,889	92,277	27,129	27,129
San Francisco	138,524	111,266	111,266	27,258	138,524		19,584	46,842
San Joaquin	61,253	48,910	48,910	12,343	61,253		8,660	21,003
San Luis Obispo	20,169	22,328	20,169		20,169	2,159	2,851	2,851
San Mateo	76,699	110,149	76,699		76,699	33,450	10,844	10,844
Santa Barbara	31,518	39,546	31,518		31,518	8,029	4,456	4,456
Santa Clara	185,525	277,242	185,525		185,525	91,717	26,229	26,229
Santa Cruz	19,473	23,186	19,473		19,473	3,713	2,753	2,753
Shasta	12,350	16,249	12,350		12,350	3,899	1,746	1,746
Sierra	280	164	164	116	280		40	155
Siskiyou	3,432	3,381	3,381	51	3,432		485	537
Solano	32,903	33,412	32,903		32,903	509	4,652	4,652
Sonoma	38,255	51,730	38,255		38,255	13,475	5,408	5,408
Stanislaus	29,101	40,962	29,101		29,101	11,861	4,114	4,114
Sutter	6,294	7,538	6,294		6,294	1,245	890	890
Tehama	3,838	3,867	3,838		3,838	29	543	543
Trinity	163	556	163		163	393	23	23
Tulare	26,899	27,510	26,899		26,899	610	3,803	3,803
Tuolumne	3,782	3,955	3,782		3,782	173	535	535
Ventura	58,155	72,837	58,155		58,155	14,682	8,222	8,222
Yolo	15,839	17,982	15,839		15,839	2,143	2,239	2,239
Yuba	4,764	3,355	3,355	1,409	4,764		674	2,083
Total	3,182,917	3,487,012	2,930,164	252,753	3,182,917	556,848	450,000	702,753

Source: State Controller's Office computed based on information from the Board of Equalization (1997-98) and Department of Finance (1999)

second alternative and the SMART formula, the cost to the State would be over \$700 million as opposed to \$450 million.

A revenue neutral property tax/sales tax swap may be appropriate and even highly productive between county and city governments within each county, but that approach translates very poorly at the statewide level. The Task Force believed that the “swap” plan was unacceptable due to its inability to conclusively resolve fiscalization among local governments.

Alternative Two - Allocation of Sales on the Basis of Population

Some observers have suggested the cessation of local sales tax revenues based upon point-of-sale in favor of a population based distribution. This alternative’s supporters argue that their approach would remove tax incentives for retail fiscalization while generally focusing and equalizing tax dollars based upon each local jurisdiction’s resident population. While an admirable goal in the long-term, the abrupt implementation of an exclusively population-based sales tax appointment would have disastrous consequences for many cities and counties over the short-range. Redistribution of retail sales taxes on the basis of population, as contrasted with allocation of sales taxes on a point-of-sale basis, results in significant disparities between jurisdictions. Those localities that have a high population relative to their sales tax collection benefit greatly while those jurisdictions with low population relative to their sales tax distribution are faced with a seriously negative position because of their past planning decisions to focus on retail sales tax enhancement.

Alternative Plan 2 — Impact of Allocating Sales Tax Based on Population Versus Point of Sale

(Amounts in Thousands)

	SMART Formula Equalization				
	Current County and City Sales Taxes	Sales Taxes Based on Population	Increase (Decrease) in Distribution	Additional ERAF Allocation	Net Increase (Decrease) in Distribution
Alameda	191,173	147,986	(43,187)	26,990	(16,197)
Alpine	289	123	(166)	22	(145)
Amador	2,792	3,516	724	325	1,049
Butte	16,506	20,853	4,347	1,253	5,600
Calaveras	1,917	3,937	2,020	407	2,427
Colusa	1,920	1,913	(8)	240	233
Contra Costa	96,275	94,612	(1,663)	14,469	12,807
Del Norte	1,511	2,901	1,390	173	1,564
El Dorado	10,490	15,567	5,076	1,485	6,561
Fresno	69,651	81,955	12,304	9,218	21,521
Glenn	1,895	2,780	885	282	1,167
Humboldt	11,127	13,231	2,103	1,534	3,637
Imperial	10,768	14,736	3,968	976	4,944
Inyo	2,169	1,885	(284)	250	(34)
Kern	57,805	66,946	9,141	6,640	15,781
Kings	7,492	13,246	5,754	1,217	6,971
Lake	3,245	5,708	2,463	565	3,028
Lassen	1,834	3,515	1,682	171	1,852
Los Angeles	881,047	1,007,400	126,353	152,833	279,187
Madera	7,251	11,956	4,705	1,023	5,727
Marin	32,017	25,604	(6,413)	4,162	(2,252)
Mariposa	1,235	1,662	427	124	550
Mendocino	8,111	9,004	893	945	1,838
Merced	13,838	21,365	7,527	2,304	9,831
Modoc	584	1,026	442	96	538
Mono	1,535	1,118	(417)	223	(194)
Monterey	37,390	40,388	2,998	4,066	7,064
Napa	12,588	12,863	275	1,764	2,039
Nevada	7,776	9,250	1,474	1,046	2,520
Orange	360,558	286,570	(73,988)	29,430	(44,558)
Placer	31,503	23,320	(8,183)	2,953	(5,229)
Plumas	1,664	2,111	448	167	615
Riverside	123,351	152,120	28,768	12,536	41,304
Sacramento	129,258	121,610	(7,647)	16,063	8,416
San Benito	3,631	4,944	1,313	323	1,637
San Bernardino	144,524	170,785	26,261	17,845	44,105
San Diego	284,166	294,602	10,436	27,129	37,566
San Francisco	111,266	81,614	(29,652)	19,584	(10,068)
San Joaquin	48,910	57,248	8,338	8,660	16,998
San Luis Obispo	22,328	24,944	2,615	2,851	5,467
San Mateo	110,149	74,627	(35,522)	10,844	(24,678)
Santa Barbara	39,546	42,241	2,695	4,456	7,151
Santa Clara	277,242	177,097	(100,145)	26,229	(73,915)
Santa Cruz	23,186	26,095	2,909	2,753	5,662
Shasta	16,249	17,079	830	1,746	2,576
Sierra	164	331	167	40	207
Siskiyou	3,381	4,577	1,196	485	1,681
Solano	33,412	40,280	6,869	4,652	11,520
Sonoma	51,730	45,809	(5,921)	5,408	(512)
Stanislaus	40,962	44,701	3,739	4,114	7,853
Sutter	7,538	7,919	381	890	1,270
Tehama	3,867	5,749	1,882	543	2,424
Trinity	556	1,363	807	23	830
Tulare	27,510	37,506	9,996	3,803	13,799
Tuolumne	3,955	5,487	1,533	535	2,067
Ventura	72,837	76,607	3,770	8,222	11,992
Yolo	17,982	16,395	(1,587)	2,239	652
Yuba	3,355	6,235	2,880	674	3,553
Total	3,487,012	3,487,012	(0)	450,000	450,000

Source: State Controller's Office computed based on information from the Board of Equalization (1997-98) and Department of Finance (1999)

The SMART Formula

In an effort to mitigate the negative results that are generated by either a property tax swap or a sales tax distribution based solely on population, the SMART Task Force developed a formula utilizing an approach that ensures fairness in revenue distribution for local entities and the State, and requires neither new taxes nor modifications to Proposition 13.

In order to adjust sales taxes partially based on a county's population, rather than where the sale occurred, the current percentage of sales tax revenues distributed county-wide and the percentage of population by county were computed. This total represents what jurisdictions countywide would normally receive under the current 1% allocation of taxable sales.

These percentages were weighted and then multiplied by the total sales tax revenues distributed in fiscal year 1997-1998, because the 1998-1999 sales tax figures were not available at the time the report was written. This was done to determine the impact of distributing some of the sales tax revenue on population versus a point-of-sale basis. To initiate the transition away from local governments' dependency on point-of-sale distribution, the Statewide sales tax revenue was redistributed so 90% was based on the previous point-of-sale method and 10% was based on population. This resulted in 15 of the 58 county-wide areas receiving less sales tax than they would have under the previous method and 43 receiving more.

Under the SMART formula, all future

increases in statewide sales tax revenues would be distributed exclusively upon population. As the growth of retail sales tax revenues over the next quarter century eventually equals and exceeds current statewide sales tax revenues, population will become the dominant factor in sales tax distribution. The "historic sales tax base" that comprises 90% of the formula in the first year will gradually become an artifact.

Finally, in order to provide the counties with some relief from the ERAF shift, the Task Force proposes an ERAF baseline reduction to approximately \$3.2 billion. The formula will also result in a \$450 million increase to local property tax revenues which will be redistributed statewide based on the proportionate county-wide ERAF contributions for the fiscal year. A limited number of ERAF contributions had to be estimated as data is not available.

The overall result of the SMART proposal, which reallocates sales taxes based on population and historic point-of-sale, and allocates \$450 million in funding to offset the loss of property tax revenue from the ERAF shift, is a net increase in tax revenues on a countywide basis for all 58 California counties.

There are a handful of cities which will experience a reduction in sales tax revenues under the SMART Formula when 10% of the sales tax revenues are initially shifted to a population basis. Many of these municipalities should be able to mitigate their losses by engaging in an intra-county swap of sales taxes for a greater share of property taxes within their municipal

boundaries. However, there are a handful of cities who will be significantly impacted during the transition. These are the cities which have overloaded their commercial centers with vast auto malls and have failed to fully develop their residential and non-retail business and industrial areas. Cities that have historically abused retail fiscalization the most will have the greatest challenges during transition.

The Task Force was convinced that the restructuring of state and local taxes would be most effective, if the suggested changes to the sales tax and property tax were undertaken in tandem. The SMART tax plan has been crafted and tested to take advantage of the counter-balancing economic effects of the proposed sales tax and property tax re-allocations. In addition, the Task Force members believed that any state and local tax proposal that did not compensate for the years of financial imbalance that have impacted California's local governments would be grossly inadequate.

In the 1999-2000 budget year the State has already earmarked \$300 million for local assistance. This money, if redistributed according to the SMART formula and guaranteed each succeeding year, would account for all but another \$150 million of the fully funded version recommended by the Task Force.

However, if the annual expenditure of \$450 million is too ambitious for some state officials, the Task Force can offer a "discount" option of only adopting that part of the SMART tax

plan which reallocates sales taxes. If the State is willing to spend approximately \$31 million, based on fiscal year 1997-1998 sales tax revenue distribution, to offset the projected countywide deficits in 15 California counties, future local planning decisions will be immediately benefited by the elimination of the "point-of-sale" tax distribution that encourages the pursuit of large retail businesses.

The Task Force believes that the financial crisis at the state and local level is too severe to adopt only a revenue-neutral proposal. If the State on an annualized budget basis fails to transfer to local government an amount sufficient for sales tax equalization for that fiscal year plus another \$150 million increment, a "hard cap" should be applied to ERAF. In this manner, the State will not receive any appreciation in property tax revenues.

While not addressing the serious revenue problems being experienced by local governments due to the diversion of property taxes, even this lower cost approach could end the fiscalization of local land use planning. By itself, it would be a noble achievement. The Task Force members also cautioned that a failure by the State to take advantage of the more comprehensive opportunities offered by the entire SMART tax plan would be tragically myopic.

The Task Force chose to exclude all special districts and less than county-wide districts from the reallocation formula for three reasons. First, those districts were created by the voters in those districts based on very specific

representations and understandings. It would be improper to alter those elements after the fact. Second, the financing arrangements for those districts are both sensitive and complex. The Task Force felt it unwise to disrupt those credit arrangements. Finally, since those districts are limited in purpose and authority to a single, narrow concern, they do not share the general planning authority that cities and counties have used to promote retail fiscalization.

Currently the intra-county allocation of tax revenues results in a pattern in which all cities are disproportionately dependent on sales tax revenues while county governments rely disproportionately on property taxes. This pattern causes two serious problems even under the SMART formula.

First, the excessive dependency of any government on a dominant, single source of tax revenue heightens the fiscal vulnerability of that government during economic cycles. Since property taxes are generally inelastic and respond relatively slowly to economic upswings, the revenue growth of county governments consistently has lagged behind the prosperity of cities within those counties during periods of economic growth. Conversely, the extreme reliance on highly volatile sales tax revenues by cities has dramatically intensified the negative impact during economic downturns.

Second, if cities increased their stakehold interest in property taxes, they would be financially encouraged to favor planning decisions that

promote high quality residential and commercial developments that could maximize each city's share of property taxes. In this manner, the increased municipal service demands of residential and commercial developments can be mitigated once the cities exchange their historical share of sales taxes for an increased share of their county's property taxes.

Also, by engaging in a revenue neutral "tax swap" at the intra-county level that balances the sources of county and city revenues, both counties and cities can benefit from a blended stabilized tax base. Such a blending will adjust for economic conditions and facilitate constructive growth.

Specifying a generic intra-county tax distribution formula was beyond the scope of the Task Force. It is, however, an important final component in the tax reallocation recommendation and should be addressed by city and county elected officials in conjunction with the proposed tax changes.

In combination with the distribution of statewide local sales taxes suggested by the SMART formula, a balanced intra-county sales tax/property tax swap can replace retail "fiscalization" with constructive land use policies.

Economic Scenarios

The Task Force has anticipated the critical observation that the SMART plan appears to yield spectacular results during periods of economic prosperity, but may result in negative consequences when an economic downturn forces austerity. Admittedly

the proposals recommended by the Task Force will not immunize California from future recession, nor will they provide a panacea to spare government leaders from the difficult decisions necessary in hard times.

However, the implementation of the Task Force's recommendations offers mitigating aspects during difficult times:

- First, by providing both state and local governments with a better mix of elastic and inelastic revenue sources, no single level of government will have its revenues disproportionately depressed in times of economic slow-down; and
- Second, by better solidifying the funding responsibilities of state and local governments, one level of government will not be able to resolve its issues by shifting problems to another level. All levels of government will be in the same boat sharing a co-dependent interest in remaining afloat.

It is undeniable that the State will need to make the greatest adjustment in anticipation of and during the next recession. The combination of the education funding obligations imposed by Proposition 98, fixed debt servicing obligations and the proposed "cap" on property tax diversions will challenge current and future State leaders. Those challenges, however, require only a minimum of financial planning and a modicum of political courage.

Since it is inevitable that the astounding growth of the late 1990's will not continue on its current robust performance pace, the State must begin to plan for a future with less economic resources now rather than later. Aggressive performance auditing throughout

State government will expose waste and inefficiency. Those savings can be added to regular set-asides to create a prudent reserve as a hedge against "bad times." This is the same minimal precautionary financial planning that the State demands from local school districts. The State could profit and protect itself by following its own advice.

In a true economic catastrophe, it may be necessary for the State to temporarily increase the property tax diversions through the ERAFs. The Task Force believed that such a situation is highly unlikely, but also did not want to foreclose the possibility should such an improbable scenario occur. Therefore, the Task Force would consider a "suspension" of the ERAF limitation, if it was accompanied by a simultaneous "suspension" of the State's Proposition 98 educational obligations. Any shortfall from the emergency year would then be repaid to local governments in the same manner that shortfalls due to suspension of Proposition 98 are repaid to school districts.

The looming retirement of the baby boomers' generation, the exploding birth rate from the "boomers' echoes" and the relatively small number of California workers in their prime earning years will very soon put California's foresight and financial planning to a rigorous test. Without immediate steps to compensate for those inevitable financial tensions, no comprehensive State and local financial reform plan — current or proposed — will save us from any

Alternative 3 — The SMART Plan (Amounts in Thousands)

	Current County and City Sales Taxes	Sales Taxes Based on Population	Sales Taxes Based on 90% Point of Sale and 10% on Population	Increase (Decrease) in Distribution	Additional ERAF Allocation	Net Increase in Distribution
Alameda	191,173	147,986	186,855	(4,319)	26,990	22,671
Alpine	289	123	273	(17)	22	5
Amador	2,792	3,516	2,865	72	325	397
Butte	16,506	20,853	16,941	435	1,253	1,688
Calaveras	1,917	3,937	2,119	202	407	609
Colusa	1,920	1,913	1,919	(1)	240	239
Contra Costa	96,275	94,612	96,108	(166)	14,469	14,303
Del Norte	1,511	2,901	1,650	139	173	312
El Dorado	10,490	15,567	10,998	508	1,485	1,992
Fresno	69,651	81,955	70,882	1,230	9,218	10,448
Glenn	1,895	2,780	1,984	88	282	371
Humboldt	11,127	13,231	11,338	210	1,534	1,744
Imperial	10,768	14,736	11,165	397	976	1,373
Inyo	2,169	1,885	2,141	(28)	250	222
Kern	57,805	66,946	58,719	914	6,640	7,554
Kings	7,492	13,246	8,068	575	1,217	1,792
Lake	3,245	5,708	3,492	246	565	811
Lassen	1,834	3,515	2,002	168	171	339
Los Angeles	881,047	1,007,400	893,682	12,635	152,833	165,469
Madera	7,251	11,956	7,721	470	1,023	1,493
Marin	32,017	25,604	31,376	(641)	4,162	3,520
Mariposa	1,235	1,662	1,278	43	124	166
Mendocino	8,111	9,004	8,201	89	945	1,034
Merced	13,838	21,365	14,591	753	2,304	3,057
Modoc	584	1,026	628	44	96	140
Mono	1,535	1,118	1,493	(42)	223	182
Monterey	37,390	40,388	37,690	300	4,066	4,366
Napa	12,588	12,863	12,616	27	1,764	1,791
Nevada	7,776	9,250	7,923	147	1,046	1,194
Orange	360,558	286,570	353,159	(7,399)	29,430	22,031
Placer	31,503	23,320	30,685	(818)	2,953	2,135
Plumas	1,664	2,111	1,708	45	167	212
Riverside	123,351	152,120	126,228	2,877	12,536	15,413
Sacramento	129,258	121,610	128,493	(765)	16,063	15,299
San Benito	3,631	4,944	3,762	131	323	455
San Bernardino	144,524	170,785	147,150	2,626	17,845	20,471
San Diego	284,166	294,602	285,209	1,044	27,129	28,173
San Francisco	111,266	81,614	108,301	(2,965)	19,584	16,619
San Joaquin	48,910	57,248	49,744	834	8,660	9,494
San Luis Obispo	22,328	24,944	22,590	262	2,851	3,113
San Mateo	110,149	74,627	106,596	(3,552)	10,844	7,292
Santa Barbara	39,546	42,241	39,816	269	4,456	4,725
Santa Clara	277,242	177,097	267,228	(10,014)	26,229	16,215
Santa Cruz	23,186	26,095	23,477	291	2,753	3,044
Shasta	16,249	17,079	16,332	83	1,746	1,829
Sierra	164	331	181	17	40	56
Siskiyou	3,381	4,577	3,500	120	485	605
Solano	33,412	40,280	34,099	687	4,652	5,339
Sonoma	51,730	45,809	51,138	(592)	5,408	4,816
Stanislaus	40,962	44,701	41,336	374	4,114	4,488
Sutter	7,538	7,919	7,576	38	890	928
Tehama	3,867	5,749	4,055	188	543	731
Trinity	556	1,363	637	81	23	104
Tulare	27,510	37,506	28,509	1,000	3,803	4,803
Tuolumne	3,955	5,487	4,108	153	535	688
Ventura	72,837	76,607	73,214	377	8,222	8,599
Yolo	17,982	16,395	17,823	(159)	2,239	2,081
Yuba	3,355	6,235	3,643	288	674	962
Total	3,487,012	3,487,012	3,487,012	(0)	450,000	450,000

Source: State Controller's Office computed based on information from the Board of Equalization (1997-98) and Department of Finance (1999)

poor choices our State leaders may make now and in the immediate future. Political procrastination, fueled by the blind hope that the inevitable collapse will occur during a successor's term of office, is a betrayal of the citizens of California.

SMART Plan's Value

The Task Force engaged in several calculations testing the fiscal impacts of this innovative approach. The analysis confirmed that the SMART formula was an approach that promoted long-term economic development without undermining current obligations. Over its initial ten-year period, the SMART formula will:

- Generate over \$4.5 billion dollars in additional revenue for local government;
- Allow the State to maintain a portion of the ERAF to substantially fund its education obligations over the next 10 years; and
- Eliminate the incentive for retail "fiscalization" of land planning decisions.

Funding of Local Mandates

Discussion of Objectives

Currently the State violates the Gann Initiative and the California Constitution by imposing expensive mandates on localities and then routinely proclaiming them to be neither mandates nor expensive. Thereafter, localities receive no financial reimbursement until their claims have wound their way through the cumbersome Commission on State Mandates process. The economic

impact on localities in the interim is negative. The objective of the SMART Task Force with regard to the funding of State mandates was to develop a mechanism that would ensure all State mandated programs are adequately funded by the Legislature before implementation.

Presentation of Plan

The Task Force recommends that whenever the State enacts a new program or increases the level of service that local governments are required to implement, the State should be required to contemporaneously appropriate funding to cover local governments' costs of compliance. In the absence of such funding, local agencies should not be required to implement the new law, executive order or regulation.

For these cases, local agencies should be allowed to seek a court-ordered Preliminary Stay of Operation suspending the enforcement of any portion of a statute, executive order, or State agency regulation imposing any additional mandated costs on local government while a test claim is pending before the Commission on State Mandates. Exceptions would be allowed if the State establishes that the appropriated reimbursement funds deposited in the State Mandate Claims fund for the specific mandate are equal to at least 75% of its reasonably projected annual costs. The Stay of Operation will remain in effect until:

- a) A supplemental deposit brings the balance to 75% of the reasonably projected annual costs; or

- b) The commission denies the test claim; or
- c) The local agency abandons its test claim.

In addition, the Task Force recommended that when local governments agree to administer a State program, bilateral compacts should be formed that incorporate specific expectations and obligations of the State and local partners. These compacts should include a commitment by the State to fund and by the locality to implement effective performance-based budgeting and performance auditing that would be appropriate to the specific program.

Value of the State Mandate's Formula

The formula devised by the SMART Task Force requires the State to affix an accurate price tag on every proposed mandate and concurrently appropriate the amount of money necessary to ensure that the local agency is fully reimbursed. Future decisions on whether to impose a mandate will be weighed against the related cost.

Governmental Accountability

The Task Force found that a particularly sensitive area of tension between the State government and the localities involves the several State-funded programs, such as health and welfare, that are administered through local governments. State representatives complained that their funding cannot be tracked to concrete results once it reaches local hands. Local representatives countered that agreements with the State seem to be in a constant state of

flux. Everyone agreed that a lack of effective communication is the root cause for the impasse.

Bilateral Compacts

The recommendation made by the Task Force mirrors the very successful approach incorporated into the State's "Workfare" program. The critical component is a bilateral compact between the funding State and the administering local government that clearly and unequivocally sets forth the obligations and the expectations of both parties. The greater the level of specificity and precision in the language of the compact, the more likely that accountability and responsibility will produce the anticipated results.

Several of the Task Force participants suggested that these bilateral compacts should include the most current budgeting and auditing tools in order to provide an accurate appraisal of performance. Performance-based budgeting and performance auditing, already established as powerful mainstays in the budget process of many governments throughout California and the nation, are useful weapons in the war against waste. Since the savings generated would be realized by the State, the Task Force was adamant that the costs of implementation should be a State expense exclusively.

Finally, the Task Force was insistent that performance auditing should become a regular tool of government applied across the board and not as only a punitive device. The potential benefits of effective performance auditing are too impressive to limit its application.

While outside the scope of this study, the Task Force encourages State government to increase its use of these approaches to generate more effective and efficient control of operations. The opportunity to realize substantial savings is too great to ignore.

Implementation

The SMART Task Force realizes that the proposals and recommendations contained in this report will require statutory amendments and may require a constitutional amendment for full implementation. As implementation of the proposals contained in this report will require a wide range of support from throughout the State, the Task Force intends to circulate the report to, and seek input from, elected State and local officials, business, union, and community leaders and Statewide stakeholder organizations.

Perspectives of Stakeholders

The Task Force’s membership represented most elements of the wide spectrum of divergent economic and political interests that together create the California political mosaic. Therefore, the Task Force was acutely aware that each positive concession made in one direction often generated a negative consequence —sometimes unintended — in another direction. The generous input from the Task Force members was essential in identifying these trade-offs. The challenge to balance these perspectives without losing sight of the ultimate goals was more daunting.

Even within a category of stakeholders, the Task Force found variances in perspectives and interest. For example, “retailers” do not speak with a common voice. The concerns of “Main Street” shop owners and “Big Box” conglomerates are often diametrically opposed. Saturation advertising and discount prices by “Big Box” retailers frequently threaten the survival of the local businesses.

Educational interests, protected by Proposition 98 guarantees, see the world from a much different perspective than higher education interests who must compete for their slice of the general revenues. The constituencies of State government unions often have demands that are incompatible with their union colleagues who belong to local public employee associations. Even among city and county leaders, the economic profiles of those they represent create alliances and conflicts independent of the level of government they represent.

Much of the time spent developing the

Task Force’s recommendations was devoted to accommodating needs, moderating consequences and generally injecting notions of fairness and equity. Obviously, if any one of the specific interest groups that participated in this exercise constructed an “ideal solution” from their own perspectives, there would be little similarities with this Task Force’s recommendations. Our Task Force members were consistently able to put aside professional self interests and adopt an attitude for the greater good. Hearing the sincere, candid concerns of their counterparts encouraged constructive and creative compromise. The valuable recommendations contained in this report reflect that process.

The Task Force acknowledges that its recommendations cannot satisfy every goal of every group with a stake in the relationship of State and local government in California. However, the Task Force does believe that its recommendations will create the financial incentives to form a more productive, better balanced future in which all stakeholders will make the necessary adjustments and ultimately prosper.

Building a Foundation for the Future

In February 1999, State Controller Kathleen Connell appointed a Task Force called the State Municipal Advisory Reform Team (SMART) and charged it with the goal of improving the fiscal relationship between State and local government in California. Composed of public and private sector leaders, labor and business representatives, county and city officials, community leaders, academics, and elected officials, this Task Force represented a wide range of perspectives and expertise. In March 1999, the Task Force began a series of meetings throughout California, inviting experts to address specific issues.

The following objectives guided the Task Force:

Tax Policy - Identify stable and reliable sources of revenue for local government that are not susceptible to diversion or preemption by State government;

Intergovernmental Accountability - Identify budgetary and auditing processes that will ensure the delivery of vital local government services; provide a reliable, predictable, and adequate source of revenue; and fully mitigate the expense of complying with State-mandated programs; and

Land Use Planning - Recommend local government land use policies that can promote long-term employment growth and sustainable economic prosperity without unduly jeopardizing traditional sources of local government financial support.

Historical Perspective

To better understand the Task Force members' consideration of these issues, a brief review of three laws is helpful. These laws, approved by voters and lawmakers over the past three decades, have had a major impact on local governments' fiscal affairs. Much of the Task Force's deliberations centered on the impact of these laws and the reforms that should be considered to restore balance to the State-local tax structure.

Proposition 13

The largest source of revenue for California's local governments was historically property taxes. That changed with passage of Proposition 13 in 1978 (California Constitution article XIII A). This measure cut local property tax revenues by 57%. Proposition 13 amended the California Constitution to provide that:

- General property tax cannot exceed 1% of assessed value;
- Property is taxed based on its 1975 assessment or its value when acquired;
- Any new "special" taxes from county, city, or school districts must be passed by two-thirds of the electorate;
- Property taxes are to be collected by counties on behalf of all local governmental entities, the proceeds to be apportioned according to law to the districts within counties;
- Any new State taxes must be passed by a two-thirds vote of the Legislature;
- State and local government cannot impose any other taxes on property; and

Prior to passage of Proposition 13 in 1978, federal, state and county governments contributed 27% of all city revenues. By 1995-1996, this figure was just 13%.

The immediate result of Proposition 13's passage was projected to be at least a \$6 billion loss of local revenues to counties, cities, school districts, and special districts. The long-term impact on local governments has been the loss of fiscal autonomy.

- The base-year acquisition value cannot increase more than 2% a year.

Among the exceptions to the acquisition-value assessment system set by Proposition 13 are:

- Market value, if lower than inflated acquisition value, establishes value for tax purposes;
- Property transferred between spouses, parents, children, grandparents, and grandchildren is not reassessed;
- Certain other events, added to Article XIII A by voter approval in the years since 1978, do not trigger reassessment; and
- Property assessed by the State Board of Equalization, such as property of State-regulated utilities, is not subject to the acquisition-value limitation.

The immediate result of Proposition 13's passage was projected to be at least a \$6 billion loss of local revenues to counties, cities, school districts, and special districts. The long-term impact on local governments has been the loss of fiscal autonomy. Local entities could no longer set their own tax rate at a level to meet their needs.

Cities adjusted in a variety of ways. Some cut jobs and services to save money and/or introduced or increased charges for services such as sewage treatment. These dedicated revenues are now the largest source of income for most cities, followed by sales tax revenues. Such services as electricity, water and sewage are provided from these revenues.

Counties confronted a different set of challenges following Proposition 13. As they already faced more legal constraints

on their taxing powers, most counties had to cut spending deeply. Rural counties especially found it difficult to meet State spending requirements. At the other end of the State, Orange County approved California's first toll road in half a century when it could not afford to build a new freeway.

Prior to passage of Proposition 13 in 1978, federal, State, and county governments contributed 27% of all city revenues. By fiscal year 1995-1996, this support was just 13%. State assistance to cities now consists of motor vehicle license fees, gasoline taxes, reimbursement of certain mandated costs, and homeowners' property tax relief reimbursements.

California's current allocation of property taxes varies among different areas depending upon the historic property tax levels and which agencies provide given services in an area. However, on average, a city resident's property tax revenues are distributed as follows: City, 14%; County, 16%; State/Schools, 52%; and Special Districts, 18%.

Proposition 98

Proposition 98, approved by the voters in 1988, amended California Constitution, Article XVI, section 8 to require the State to commit a prescribed amount of State funding to school districts and community college districts. The State's contribution to schools would never be less than the percentage of State General Fund revenues allocated to schools in fiscal year 1986-1987, which was 40%.

Though not anticipated at the time it was adopted, Proposition 98 eventually would impact local funding. This began

occurring in fiscal year 1992-1993 when the State, facing a severe budget shortfall, opted to require local governments to shift property taxes to schools. The Legislature directed each county auditor to establish a special fund, the Educational Revenue Augmentation Fund, or ERAF. Using a formula established by the Legislature, county auditors were directed to reduce the allocation of property taxes that each local government entity would otherwise receive and place the diverted funds into the ERAF.

The ERAF funds were allocated to local school districts, but only if the allocation would result in dollar-for-dollar savings to the State. The Legislature then reduced the State allocation to schools (the “backfill” amounts) by the amount funded through local ERAFs, approximately \$1.2 billion in fiscal year 1992-1993.

The practice was continued the following year, based on new legislation that required the following:

1. The amount of property tax deemed allocated to each county, or city and county in the prior fiscal year was reduced by an amount equal to 80 cents per resident. Similar reductions were required for cities.
2. Property tax allocations for each county were reduced in accordance with calculations in the “Estimated County Property Tax Transfer Under Governor’s May Revision Proposal,” published by the Legislative Analyst’s Office (1993).

As in the prior year, this shift was intended to reduce the State obligation under Proposition 98 by an equal

amount. Once again, the Legislature calculated the percentage of General Fund revenues due the schools as if the fiscal year 1993-1994 tax shift had also happened in fiscal year 1986-1987, thus reducing the State’s potential educational funding obligations as a part of the State budget from 40% to 34%.

Since each ERAF is defined as a “school entity” and has been granted the status of a governmental entity, each ERAF is due an allocated “share” of the property tax. The amount of property tax revenues shifted from what local governments would have received without ERAFs continues to grow as gross annual property tax receipts increase. The ERAF shift reached \$3.6 billion as of fiscal year 1998-1999.

***Proposition 4:
The Reimbursement Process for
State-Mandated Activities***

The concept of State reimbursement to local agencies and school districts for mandated activities originated in the Property Tax Relief Act of 1972, Senate Bill 90, Chapter 1406, Statutes of 1972, commonly known as SB 90. The primary purpose of SB 90 was to limit the ability of local agencies and school districts to levy taxes. As an offset for these State-imposed limitations, the Legislature declared its intent to reimburse local agencies and school districts for the costs of new programs or increased levels of service mandated by State government.

In 1979, the votes approved Proposition 4, the Gann Initiative, which added article XIII B to the California Constitution. Section 6 of article XIII B states that, whenever the Legislature or any State agency mandates a new program

or a higher level of service on local government, the State must reimburse the associated costs, with certain exceptions: 1) mandates requested by the local agency; 2) legislation defining a new crime or changing an existing definition of a crime; 3) a mandate that existed prior to January 1, 1975; or, 4) when the federal government bypasses the State and directly imposes costs on local agencies for federally mandated programs.

Given that this constitutional amendment was primarily concerned with imposing appropriation limits on the tax proceeds of both State and local government, Section 6 of article XIII B was superimposed on SB 90. Originally, the Board of Control was identified as the body with the authority to hear and decide claims requesting reimbursement of costs mandated by the State.

Subsequently, on January 1, 1985, the Commission on State Mandates was created as a quasi-judicial, deliberative body with the primary responsibility to hear and decide claims brought by local agencies and school districts that believe they are entitled to reimbursement for costs mandated by the State.

The Commission currently consists of seven voting members in three categories: constitutional members (the State Controller and the State Treasurer); executive branch (the Director of the Department of Finance and the Director of the Office of Planning and Research); and three public members.

California Government Code Section 17525 (b) requires that, of the three public members, one must have

experience in public finance, and two must be elected local officials from either a city council, a county board of supervisors, or a governing board of a school district. All public members are appointed by the Governor, subject to Senate confirmation, and serve a term of four years, subject to renewal.

The traditional parties before the Commission are local governments, school districts, special districts, and affected State agencies such as, the Department of Finance or the State Controller's Office. Even though both of these State offices have votes on the Commission, there has never been a disqualification imposed on a voting member. Instead, a majority of the members have consistently left the decision to recuse on an item to the member with the perceived conflict. This has sometimes increased the distrust by local governments and school districts appearing before the Commission.

The projected elapsed time from the filing of a test claim until the Commission finally approves a Statewide Cost Estimate for inclusion in the "Local Government Claims Bill" is approximately 18 months, assuming there are no unforeseen complications causing further delay.

Whenever a local government claimant or an affected State agency is the recipient of an unfavorable determination by the Commission, the dissatisfied party may challenge the decision by filing an action in Superior Court, an increasingly technical process that can take several years before final judgment.

Even a resolution of all of the administrative and judicial procedures does not translate into immediate reimbursement for the expense of a State-mandated program. The local claimants must then present detailed documentation supporting their reimbursement claims to the State Controller's Office for review. A disagreement at that point brings the parties back to the Commission with an Incorrect Reduction Claim.

As a result of this process, some test claims filed in 1992 are still pending. Meanwhile, the affected local governments are obligated to fully perform as the State has mandated, trying to finance compliance costs from a smaller revenue base.

Tax Policy

In considering ideas for constructive change in the structure of the financial relationship among the State, local governments, and the California taxpaying public, both individual and business, the SMART Task Force subcommittee on tax policy recognized the status quo could prove a powerful opponent.

Local governments - county and city, rural and urban - all struggle to secure the financial resources required to provide the level of service their public needs, expects, and desires. Success comes to different areas in different degrees and by different means. Yet each locality strives to locate dependable revenue sources. For some, it is growing tourism in order to secure the sales and hotel occupancy tax revenues tourism brings. Other localities have encouraged development with an eye toward higher property values and the resulting increase in property tax revenues. Still others have turned to retail or auto malls to draw consumers and their sales tax dollars from surrounding areas.

Over the years, local governments, communities, and businesses have made decisions and planned for the future based on the incentives built into the current tax structure. Changes in tax systems and relationships are not easily made. It is axiomatic that any prescription for change will create winners and losers. Yet a system that does not deliver adequate resources fairly or efficiently requires change for a better and more secure future. As members of the tax policy subcommittee noted,

Changes in tax systems and relationships are not easily made. It is axiomatic that any prescription for change will create winners and losers. Yet a system that does not deliver resources adequately, fairly, or efficiently requires change for a better and more secure future.

one size does not fit all; even when change is initiated, consideration must be given to the range of local situations.

Need for Local Control

The tax policy subcommittee believes policy makers, in undertaking change in local government financing, should make certain to retain a focus on local control. Local governments are best able to determine local needs and should be given the ability to set up revenue streams to meet those needs. Currently, local governments often must chase grant monies established by State or federal authorities. Often, the macro choices the State or federal government makes may not be the choices local government representatives would select for their own community. Indeed, although money may be available, a local government's failure to adequately address locally voiced needs could be related to factors beyond the local government's control. When the State or federal government releases funds to localities to address what may be perceived as peculiarly local problems, that money often comes with strings attached. In many such cases, the local government is not truly free to determine how best to expend those funds in the context of its community.

Filters for Any Proposal

The tax policy subcommittee recommended a series of "filters" for analyzing the feasibility of any suggested solution to the revenue challenges facing local governments. These filters are: Stability, Predictability, Reliability, Fairness, Connection to Services, Accountability, Economic Efficiency,

and Viability. While some may appear synonymous, each has a distinct meaning. The filter definitions are:

Stability - Whether the solution will provide a stable revenue stream to local government so it is not unduly subjected to the vagaries of the business cycle and can provide a generally stable level of service to the public. Importantly, the subject of the tax should not be so easily moved that people could make tax considerations their decision point;

Predictability - Whether the solution will provide a predictable revenue stream so taxpayers can budget appropriately for their tax obligations and local governments can have a realistic basis on which to plan expenditures and savings for an improved level of service to the public; importantly, the fiscal pressures of State government should not change the amount of money flowing to local government;

Reliability - Whether the solution will assure that the revenue source to local government will not be withdrawn.

Fairness - Whether the solution will be fair in terms of its impact among classifications of taxpayers or among taxpayers generally;

Connection to Services - Whether the solution will provide a revenue stream that is connected or reasonably related to services provided by the local government to the taxpayers who fund the revenue stream;

Accountability - Whether the solution will provide an auditable tax method to ensure proper and full collection and to allow local government to be held accountable for any changes;

Economic Efficiency - Whether the solution will provide a tax that will be a natural reflection of the marketplace and will minimize tax avoidance planning by not unduly influencing taxpayer behavior; and

Viability - Whether the solution will create a tax method to make the solution politically viable (and even acceptable) where taxpayers or local governments might otherwise be drawn to oppose the solution were it to be broadly stated.

Property Taxes are Local Revenues

The tax policy subcommittee considered whether property taxes should be permanently returned to local governments and schools and not be used to absorb the State government's General Fund obligations. The justifications for this consideration were simple: the property tax is a traditional revenue source for local government in California; the services provided by local government have a close and substantial connection to the property within the local government's jurisdiction; and the perception of the general taxpaying public is that the property taxes it pays stay within the local community.

However, while the elimination of all property tax funding for state government services works in principle, the Task Force's projections demonstrate that it collapses in practice.

The subcommittee believes the State should undertake full funding for items that are truly within the Legislature's purview and responsibility, such as the trial courts.

Proposition 13 is Here to Stay

According to conventional wisdom, the

The sales and use tax historically has been an important discretionary revenue source for local governments. The tax policy subcommittee concluded that future growth in local sales and use tax revenues should be allocated among the various local jurisdictions on a per capita basis rather than the current point-of-sale basis.

financial problems of local government and the proliferation of fees and other charges are due to Proposition 13 and its progeny. While Proposition 13 was a reaction to the financial stresses property owners faced during a time of rapid value increases and tax rate hikes, it is an acknowledged part of the political landscape. Since 1978, the voters have proved willing to add exclusions from changes in ownership, which they presumably would not readily give up, further restricting the growth of property tax revenues. Even split-roll proposals, which would assess business property differently, have been unsuccessful with the voters.

Several of the Task Force members expressed considerable concern that Proposition 13 may unfairly impact new homeowners by disproportionately increasing their property tax obligations vis-a-vis existing homeowners, thus, adversely impacting housing affordability. They also expressed concern that Proposition 13 has had the unintended effect of stifling competition in the commercial sector by forcing new or relocated businesses to absorb a higher property tax obligation compared with established competitors. These Task Force members believe that detailed studies of Proposition 13 winners and losers may reveal inequities that could be resolved by periodically reappraising commercial properties and moderating the impact of higher taxes on home purchasers without increasing taxes on existing homeowners.

The majority of the Task Force members felt that these types of detailed studies may be appropriate for a future focused study group, but such studies were beyond the resources of this Task

Force. On a more pragmatic level, the voters have resisted prior attempts to treat commercial properties differently through any sort of split-roll proposals. The tax policy subcommittee concluded that any recommendations concerning split-roll were premature and not viable in the current political environment.

Sales and Use Taxes should be Reallocated

The sales and use tax historically has been an important discretionary revenue source for local governments. The tax policy subcommittee concluded that future growth in local sales and use tax revenues should be allocated among the various local jurisdictions on a per capita basis rather than the current point-of-sale basis. The “point-of-sale” allocation of sales and use tax revenues is responsible for today’s “cash-box” approach to land use planning, contributing to unbalanced development (discussed in greater detail by the Task Force subcommittee on land use planning).

The tax policy subcommittee focused on the local general purpose portion of the sales and use tax. Generally understood as a single tax, the total sales and use tax rate is actually comprised of several separate but conforming taxes. The State tax is imposed at 6%. The local sales tax is 1-1/4%, with 1% for local general purposes and the remaining 1/4% for transportation development. Separate transit and other special district taxes are up to 1-1/4%.

While calling for a change in the current point-of-sale method of allocating local sales and use tax revenues, the tax policy subcommittee felt an immediate reallocation based on population would

not be viable. The current system has been in place for many years. Local governments and taxpayer-merchants have made land use planning and business location decisions that rely on this revenue stream. Many localities will believe they have too much already invested in this long-standing system to readily release revenues authorized by local ordinances, in compliance with the law, and on which their long-term financial planning and budgeting have been based.

However, it is hoped that, as localities recognize and appreciate their collective need for a well-rounded approach to community planning, they will endorse a broader and less divisive and distortive method of allocating future growth in local sales and use tax revenue. Thus, the tax policy subcommittee recommends that future growth in local sales and use tax revenues be allocated on a per capita basis. However, the subcommittee acknowledges that an allocation that appears fair today could result in inequities over time.

Broadening the Sales and Use Tax Base

The sales and use tax base is increasingly narrow. The tax policy subcommittee briefly discussed broadening the base in conjunction with lowering the rate in order to increase local discretionary funds. Sales tax exemptions traditionally have been used as a means to encourage various industries or to avoid adding a regressive burden to basic necessities, such as food.

Since California's economy is increasingly service oriented, adding services to the base is the most logical choice for broadening the scope of the sales and use

tax. However, the members of the tax policy subcommittee also noted that revenues from the addition of services would be subject to the business cycle, and strongly opposed by the business community. Therefore, the subcommittee did not make any recommendations in this area.

Exchange of Sales Tax for Property Tax

Reversing the property tax shift of the early 1990s is a major political and financial goal for local governments. The tax policy subcommittee discussed whether a return of property tax revenues to local governments should be coupled with dedication of all sales and use taxes as State General Fund revenues.

The subcommittee considered mainly the general purpose local taxes. Dedicating sales and use taxes as State General Fund revenues should eliminate the distortion the current point-of-sale allocation method has caused in land use planning decisions. Trading a return of property taxes for sales and use taxes thus could be an attractive solution.

However, at least two significant concerns arise. First, since the passage of Proposition 13 and even more so since the State created the ERAFs, local governments have focused more and more on sales and use taxes as a replacement for property taxes. At this point in time, the State's share of the property taxes are dwarfed by the local sales taxes. A dollar-for-dollar "swap" in the common notion is financially impossible. Second, and perhaps more important, sales and use tax, have become the primary domain of the cities. Trading a return of property taxes for the local

sales and use tax revenues would result in a disastrous shortfall for city governments. Such a trade would mean only that, instead of a property tax shift, there would be a sales and use tax shift that would cripple the high growth urban center. City governments rightly would perceive the trade as continued usurpation of their local government revenues for the benefit of State and county government. All levels of local government are seeking not only to recover the money they lost in the property tax shift, but also to generate additional revenues so they can adequately support local government services.

local community level to assure revenue-raising authority is associated with spending authority. Representative local government now must rely on the direct democracy of the ballot box to obtain needed financial resources. In a “don’t tax you, don’t tax me, tax that guy behind the tree” world, local government must find ways to persuade voters that the health of the community matters to each individual and each property in the community. Listening to constituents and being accountable for financial decisions should assist in convincing voters that local governments must have authority over resources to do the job the community expects.

Income and Franchise Taxes

The subcommittee discussed whether the personal income and/or the corporate income and franchise tax should be replaced with an alternative tax scheme such as a consumption or value-added tax. However, it was concluded that no such change should be undertaken as long as the federal income tax system remains in place. The efficiencies gained from the dual income tax system for government and taxpayers alike support continuity.

Tiplers’ Tax

The subcommittee considered having the State authorize counties to impose a tiplers’ tax, a tax on alcoholic drinks served, since counties have not been as successful as cities in locating additional discretionary revenue sources post-Proposition 13. However, a tiplers’ tax would not appear to pass the analytical filters the tax policy subcommittee recommends.

Conclusions of the Subcommittee

California must renew its dialogue at the

Local governments believe they are viewed by State government as existing only to provide revenue to Sacramento on demand regardless of the resultant financial impact on critical local services.

Over the past seven years, the State has shifted approximately \$21.5 billion in property tax monies away from local entities.

Intergovernmental Accountability

The greatest concern among local elected leaders is that State government officials no longer regard their local counterparts as “partners” in the multidimensional challenge of providing appropriate governmental services in the most efficient and effective manner. Instead, local officials are convinced that California State government has been balancing its budget on the backs of municipal government by either confiscating traditional revenue sources or forcing localities to substantially underwrite State programs. These were the views that emerged from the discussions of the SMART Task Force subcommittee on intergovernmental accountability.

State Control of Local Revenues

Local governments believe they are viewed by State government as existing only to provide revenue to Sacramento on demand regardless of the resultant financial impact on critical local services. Over the past seven years, the State has shifted approximately \$21.5 billion in property tax monies away from local governments.

Even with the historic State surplus in 1999, the State’s “largesse” toward local governments was almost token. The State budget for fiscal year 1999-2000 provided local governments with \$150 million, half going to cities and counties based on population and the other half based on the amount of property tax the State transfers from these entities each year.

Essentially, the State government has sacrificed county-run programs, most notably health, community

services, and local infrastructure, to subsidize its own budget needs. The subcommittee concluded that the only way to correct this imbalance is to restore the property tax as the primary revenue source for local governments and to minimize the impacts of the ERAF.

Unfunded State Mandates

The subcommittee members discussed the State’s practice of regularly disregarding its legal and ethical obligation to fully fund expenses incurred by local governments that result from State-mandated programs or increased levels of service. Many local officials believe it is irresponsible for State elected leaders to take public credit for legislation without accurately disclosing the price tag that accompanies the new program. Local governments deeply resent being compelled to comply with State-mandated programs regardless of cost, particularly when there is no adequate or timely reimbursement from the State.

For example, Task Force members from relatively rural Mariposa County estimate that the new State-mandated program imposing a stringent regimen on animal control agencies for the care of recovered animals will increase that county’s annual animal control budget from \$30,000 to roughly \$300,000. Counties were to comply by July 1, 1999. However, the State has provided no funding to absorb the cost of this program’s implementation.

In instances where the locality does seek reimbursement for the costs imposed by a State mandate, the process to secure that compensatory funding is tedious, complicated, and dominated by State government interests. The complexity

of the mandate process is demonstrated by the overview flow chart shown on the following page that was created by the Commission on State Mandates to “facilitate” understanding. Meanwhile, through all the delay, local governments face the challenge of identifying resources to self-fund the State’s mandate.

Given the enormous strain this places on local budgets, the subcommittee members recommended that the State be required to affix an accurate price tag to every proposed mandate and concurrently appropriate the amount of money necessary for full reimbursement. This would be accomplished by requiring any legislation, executive order, or State agency regulation that imposes any costs on local entities to be accompanied by an Economic Impact Projection (EIP) prepared either by the Legislative Analyst’s Office or the Department of Finance. The EIP would identify the amount of annual reimbursement to which affected local entities will be entitled.

Every bill, executive order, or State agency regulation subject to the EIP, including those containing an urgency clause, would be required to include a contemporaneous appropriation to provide immediate reimbursement. The amount should equal or exceed the projected reimbursement cost identified in the EIP. These funds would then be deposited in the State Mandate Claims Fund, where they would be separately held and applied only to reimburse costs of the specific mandate for which they were deposited. If the funds are not deposited, local agencies would not be required to implement the new law, executive order, or regulation.

The subcommittee members recommended that the State be required to affix an accurate price tag to every proposed mandate and concurrently appropriate the amount of money necessary for full reimbursement.

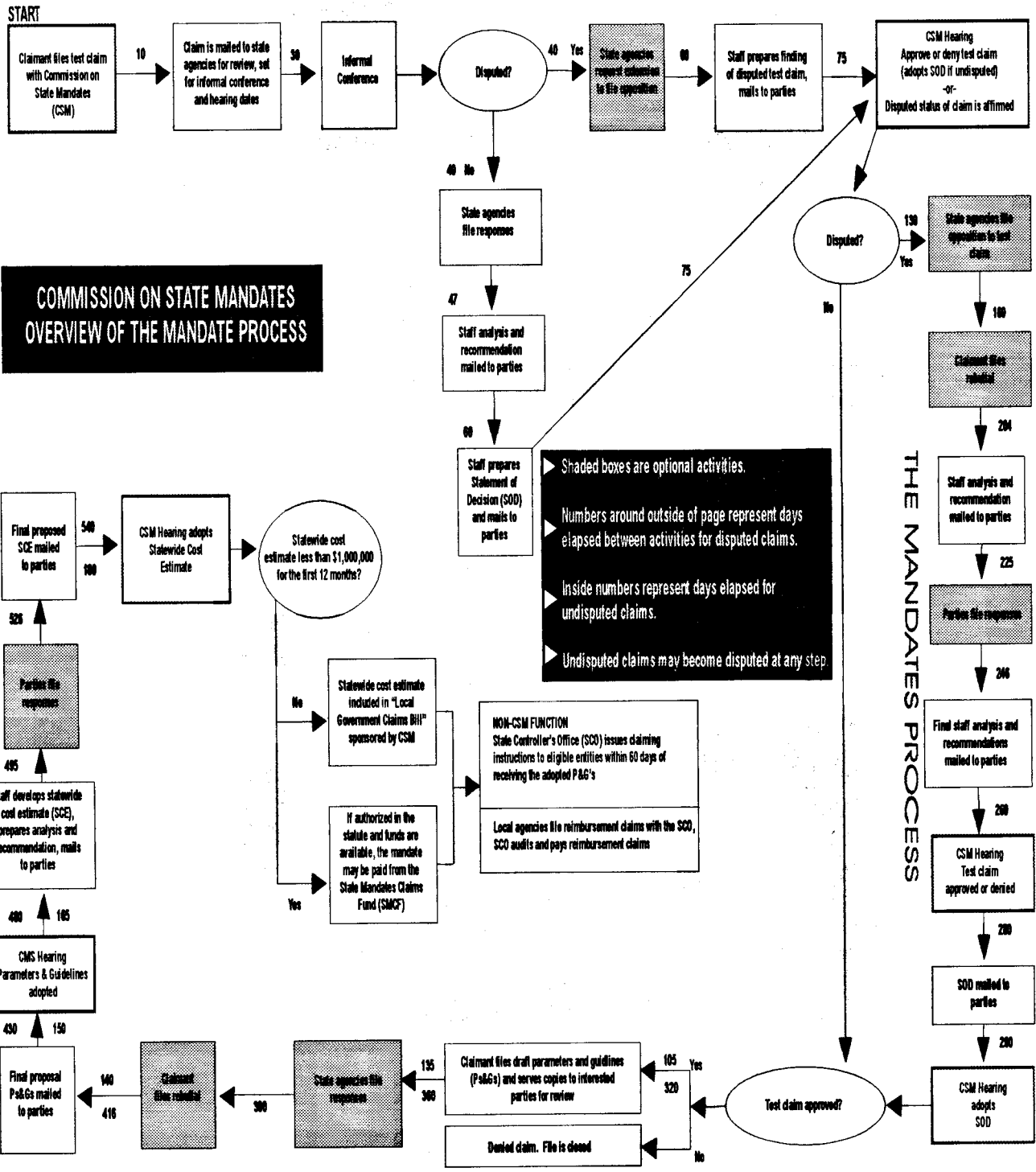
In conjunction with this recommendation, the subcommittee believes any affected local agency should be allowed to file for an injunction seeking a Preliminary Stay of Operation of any portion of any statute, executive order, or State agency regulation while a test claim is pending before the Commission on State Mandates. The Stay should be issued unless the State establishes by a preponderance of the evidence that the reimbursement funds deposited in the State Mandate Claims Fund for the specific mandate are equal to at least 75% of the reasonably projected costs of the mandate.

Such a stay would remain in effect until one of the following occurs: 1) A supplemental deposit is made bringing the deposit to a level equal to 75% of the reasonably projected costs, as determined by the court; 2) The Commission on State Mandates issues a Statement of Decision denying the claim and issuing the Statewide Estimate of Costs for the mandate; or 3) The local agency abandons its claim.

This State responsibility for making full financial disclosure should commence the day the mandate takes effect.

State and Local Partnerships

Currently, there are more than 100 programs funded by the State and administered through local governments that display the potential for true intergovernmental cooperation, where each partner is accountable to the other. The subcommittee believes such partnerships should be encouraged. In addition, the subcommittee feels local entities that administer State-funded programs have an obligation to strictly account for the manner in which those



Local governments cannot be treated as “colonies of Sacramento,” if California is to rebuild a strong web of governmental support that so effectively served the needs of its citizens in the past. To act otherwise would ultimately destroy the entire system of government in California by eroding the foundation of local government.

funds are spent.

To promote this objective, the subcommittee recommended that where such partnerships are created, the State and local entities should enter into bilateral compacts that incorporate the specific expectations and obligations of each party. Included within these compacts would be a commitment by the State to fully fund and the locality to effectively implement some forms of performance-based budgeting and performance auditing that would be appropriate to the specific program.

The subcommittee members also felt local governments should engage in revenue sharing when it is coupled with shared responsibility for services to the public. For example, some Task Force members said Sutter and Yuba counties are partnering in the delivery of mental health services to their residents. Such consolidated approaches have the potential for offering more comprehensive services in a cost-efficient manner than either of the partnering entities might be able to offer on its own. Local governments should be given tools that will encourage, where appropriate, consolidated approaches to difficult financing and service delivery challenges. This also will minimize inter-governmental rivalries for scarce resources.

Conclusions of the Subcommittee

The State should be able to rely on local governments to competently administer State-funded programs, but the fiscal health and viability of those local governments will determine their effectiveness as administrators. Superimposing additional budgeting and auditing controls on local government,

such as performance-based budgeting or performance auditing, without a stipend to absorb the costs is ill advised. Local leaders would welcome any new approach that will make government spending more efficient and effective as long as the costs of additional auditing services can be passed through to the State, and the State will live up to its obligations.

Local governments cannot be treated as “colonies of Sacramento,” if California is to rebuild the strong web of governmental support that so effectively served the needs of its citizens in the past. To act otherwise would ultimately destroy the entire system of government in California by eroding the foundation of local government.

The collective effect of these trends is that the sales tax is now the premier source of revenue for local governments. Far too often, local officials are setting aside sound planning principles as they compete for revenue-producing projects, a phenomenon that has become known as the “fiscalization of land-use.”

Land Use Planning

The land use planning subcommittee found that inappropriate land use decisions are being made in large part due to the State-local tax structure. While recommendations to revise this structure were left to the Task Force’s tax policy subcommittee to develop, the land use subcommittee focused on how future land use decision-making would be improved, if the fiscal relationship between California State government and local governments was altered.

Proposition 13 and the Fiscalization of Land Use

Since passage of Proposition 13 in 1978, the State has controlled the distribution of tax revenues among local governments. Local governments’ property tax revenues have plummeted over the last two decades, in part, due to Proposition 13. To compensate for deep cuts in property taxes, local governments have increased developer fees and homeowner charges to fund the services that new residential and commercial developments require, such as roads, parks, sewers, schools, and police and fire protection.

While the fees typically are for long-term funding of such services, the higher up-front costs hinder development. Local governments may deny approval for new developments, or make approval hard to obtain, if it is deemed the development will not pay its way in terms of funding services. One kind of permitting bias that has grown in the post-Proposition 13 era works against moderate-income homeowners. Local governments have come to favor upscale homes with large lots over smaller-lot homes because the former

represent lower housing density and hence lower infrastructure costs.

Proposition 13 has skewed land use and economic development in a number of ways that do not necessarily serve the community’s best interests. Retail growth is now preferred over manufacturing and other industrial growth because it generates sales tax revenues. Financially struggling cities and counties compete to attract shopping malls, discount clubs, and auto malls. In many cases, neighboring cities have launched bidding wars to attract big retailers while looking skeptically at prospective manufacturing or R&D developments. Given strong public support of Proposition 13, efforts to revise it to address these stifling effects on growth and rebuild depleted infrastructure have met stiff opposition.

The collective effect of these trends is that the sales tax is now the premier source of revenue for local governments. Far too often, local officials are setting aside sound planning principles as they compete for revenue-producing projects, a phenomenon that has become known as the “fiscalization of land-use.” The land use planning subcommittee concluded that reform of the tax structure, which was dealt with by the Task Force subcommittee on tax policy, is critical to restoring the appropriate balance in land use decision making.

The ERAF Shift

Although the property tax shifts played a critical role in helping California resolve its severe budget difficulties in the early 1990s, these shifts also negatively affected local governments’ incentive to approve new land develop-

ments and, to a lesser degree, to properly administer the property tax collection system. Local governments do not have as much control over property taxes as they did in the past, and property taxes are no longer as high a priority for them. For this reason, the land use planning subcommittee believes State lawmakers should phase out the ERAF shift as soon as possible.

Housing

Aside from land use issues related to the tax structure, the subcommittee found housing to be the most critical land use challenge facing California. Currently, business and job growth do not balance with housing growth. Many jobs have been created due to the economic boom in California, which also has driven up the demand for housing. However, new residential construction has been somewhat slower in parts of California. For example, in 1998 in Orange County, there were 61,000 new jobs created, but only 10,000 building permits were issued.

The location of housing is another key concern. California needs to develop incentives for people to live relatively close to their workplace. Business leaders are demanding affordable housing to attract talent to California (especially in high growth areas such as the Silicon Valley). Employees also want affordable housing near their workplace. To address these needs, the subcommittee believes stronger incentives should be put in place to increase construction of affordable housing, including multi-family dwellings, in urban centers. In addition, many older neighborhoods need to be improved and maintained. This should include

construction of new schools and job-training centers. Improving the livability of urban centers will increase private sector investment in those communities and help stem flight to the suburbs.

Construction Defect Litigation Limits

Multi-Family Housing Construction

Since the 1980s, new multi-family residential construction has been falling as a percentage of total residential construction. The major reason for this tremendous drop is that construction defect litigation has opened the door to unnecessary lawsuits against the owners of new multi-family dwellings. Developers of multi-family housing face the added burden of strict liability for construction defects and a 10-year period when a suit may be filed. This, in turn, has resulted in both contractors and subcontractors being unable to obtain insurance. Although California needs more multi-family housing, current litigation practices have all but stopped its construction.

The subcommittee concluded that State law needs to be changed to increase the incentives for multi-family and entry-level housing.

Regional Needs vs. the “Nimby” Syndrome

Many communities that are experiencing a sharp increase in new jobs, such as San Francisco, also have a growing need for high-density housing. However, the communities themselves generally oppose more high-density housing due to its local impact on open space, congestion, and aesthetics. “Not in my back yard” arguments often prevail over regional planning goals.

The land use planning subcommittee

Lack of infrastructure funding in recent years has become a major crisis for California. As with other issues addressed by the SMART Task Force, the availability of resources for this purpose has been largely dictated by the fiscal relationship between the State and local governments.

considered whether financial incentives should be developed to reward communities with “growth” policies, which would not be available to communities with “no growth” policies. However, no recommendations were made in this area.

California Housing Finance Authority and Related Agencies

California has 11 of the 25 least affordable communities in the entire nation. To combat its shortage of affordable housing, California created the California Housing Finance Authority (CHFA). Acting as the State’s mortgage bank, the CHFA offers below-market rate mortgage financing to meet the housing needs of low- to moderate-income families. Assembly Bill 1404 (Dutra), introduced this year, would increase the CHFA’s debt limit from \$6.75 billion to \$8.95 billion. The subcommittee strongly encourages all such measures to increase funding for, and consequently the availability of, affordable housing. At the same time, California should review how these funds are allocated to ensure that innovative plans that address the greatest housing needs are being funded.

Military Bases for Housing

The closure of military bases represents a potential partial solution to the shortage of affordable housing in California. Especially in Northern California, military bases generally are located near urban centers. The land could be used for what it already provides, for example, housing. However, as seen in other parts of the State, these bases may become sites for large retail or commercial ventures instead of

housing. While the land use planning subcommittee was favorably impressed with the concept of using closed military bases for expanding the availability of affordable housing in urban areas, it did not make a specific recommendation.

Infrastructure

Lack of infrastructure funding in recent years has become a major crisis for California. As with other issues addressed by the SMART Task Force, the availability of resources for this purpose has been largely dictated by the fiscal relationship between the State and local governments.

The subcommittee noted that local entities would be better able to address the infrastructure challenges that surround them, including outdated sewer systems and roadways, if they were allocated more than the small portion of property tax they currently receive. Currently, as they lack the resources, city governments are taking two actions to address infrastructure needs: raising developer and homeowner charges and opting for development of upscale homes with large lots over smaller homes.

The subcommittee recommends that an increase in funding for infrastructure should be used in support of affordable housing and modernizing infrastructure in urban areas. Decaying downtowns should be rebuilt and modernized. The effect of suburban and edge-city sprawl will be greatly improved through funding for transportation, mixed use in-fill, and habitat protection.

Performance-Based Funding for Infrastructure

A common problem with funding infrastructure projects is the lack of data on project effectiveness. Where data is collected, there is little nexus between the project's success and future funding. For example, the State has apportioned hundreds of millions of dollars to improve public transportation, but statistics have shown that the increased funding did not translate into increased ridership. Often, government support for these types of projects is not contingent on showing the effectiveness of the spending. The subcommittee concluded that, if the State increases the use of performance measures when allocating resources, those resources will be used more efficiently, and only where they provide significant benefit.

Increasing Local Government Communication

The subcommittee discussed the need for local governments to improve communications with respect to infrastructure spending, thus enhancing efficiency. California should consider adopting several city planning procedures within the optional elements of the general plan guidelines published by the Governor's Office of Planning and Research. The State should provide fiscal incentives to encourage cities to follow one of the adopted measures. However, the subcommittee concluded that specific guidelines should be developed by a joint Task Force of State and local officials, rather than the SMART Task Force.

Land Use Objectives for the 21st Century

The land use planning subcommittee

determined that certain objectives should guide local governments in planning their communities. After much deliberation, the subcommittee developed the criteria it believes should guide this decision-making, with particular attention to the differences between new development and existing development. These criteria are described below.

New Communities - Ideally, new communities in California should be integrated so they include housing, shops, work places, schools, parks, and civic facilities that are essential to the daily life of the residents. Community size should be designed so that housing, jobs, daily needs, and other activities are within easy walking distance of each other. These communities should include diverse housing types, enabling citizens from a wide range of economic levels and age groups to live within its boundaries.

Urban Communities - The subcommittee agreed that urban communities often lack a central focus that combines commercial, civic, cultural, and recreational uses within easy walking distance of transit stops. Each community or cluster of communities should have a well-defined edge, such as agricultural greenbelts or wildlife corridors, permanently protected from development. Regional land use planning structure should be integrated within a larger transportation network built around transit rather than freeways. Regional institutions and services (e.g., government offices, stadiums, and museums) would be located in the urban core.

Existing Communities - The subcom-

mittee concluded that the financial and time costs necessary to achieve these ideals in existing metropolitan communities are too high in relation to the results achieved. In developed areas, California must use existing social and physical infrastructure while permitting in-fill and interconnected communities. However, by improving land use decision-making, communities can achieve cleaner air and water, less traffic congestion and more affordable housing while reversing and/or controlling sprawl, at the lowest possible social and financial costs.

Conclusions of the Subcommittee

The fiscal realities of the post-Proposition 13 world create great disincentives for wise land use policy in California. Until those fiscal factors are addressed, California's local governments will continue to forego "smart" growth in favor of new revenue sources.

Each community in California is unique. The State government should be wary of mandating local land use processes. Rather, the State should focus on providing adequate financial resources for those communities to make their own land use planning decisions. Given adequate resources, local governments are far more likely to make balanced and appropriate planning decisions, which will protect open spaces, promote adequate housing, and improve California's economy.

**Percentage of Local Revenues & Expenditures for California
Cities and Counties for the Period of July 1, 1993 through June
30, 1997**

Cities Revenues	1993-94	1994-95	1995-96	1996-97
Service Charges (Sewage, Water, Electricity)	41 %	41 %	41 %	39 %
Sales and Use Taxes	10	10	10	9
State and Federal Taxes	12	13	13	13
Property Taxes	7	7	7	6
Revenues from Use of Monies and Property	4	4	5	4
Utility Taxes	4	4	4	4
Business License Tax	2	2	2	2
Licenses and Permits	1	1	1	1
Transportation Tax	1	2	2	1
Other	18	16	15	21
Total	100 %	100 %	100 %	100 %

Counties Revenues	1993-94	1994-95	1995-96	1996-97
State Aid	42 %	39 %	42 %	43 %
Federal Aid	22	21	21	21
Property Taxes	15	11	12	12
Service Charges, Miscellaneous Revenues and Other Financing Sources	12	21	17	15
Sales Tax and Other Taxes	3	3	3	3
Other	6	5	5	6
Total	100 %	100 %	100 %	100 %

Cities Expenditures	1993-94	1994-95	1995-96	1996-97
Public Safety (Police, Fire, Paramedics)	26 %	26 %	26 %	26 %
Public Utilities (Gas, Electricity, Water)	21	21	20	20
Community Development and Health	21	21	22	22
Transportation (Streets)	15	15	15	15
Parks, Recreation, Libraries	8	9	9	8
General Government	9	8	8	9
Total	100 %	100 %	100 %	100 %

Counties Expenditures	1993-94	1994-95	1995-96	1996-97
Public Assistance (Welfare)	41 %	38 %	40 %	38 %
Public Protection (Gas, Electricity, Water)	27	25	28	29
Health and Sanitation	17	14	14	16
Administration and Elections	9	15	9	9
Roads	3	3	3	3
Education, Recreation, Culture, Debt Service	3	5	6	5
Total	100 %	100 %	100 %	100 %

Source: State Controller's Office Annual Financial Transaction Reports

Education Revenue Augmentation Fund (ERAF) Shift (Amounts in Thousands)

	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Alameda	71,413	176,746	190,541	191,974	195,207	207,221	217,426
Alpine	22	131	22	150	152	169	174
Amador	558	1,997	2,019	2,110	2,120	2,433	2,438
Butte	3,773	12,689	13,243	11,302	10,081	10,461	10,869
Calaveras	1,041	2,614	2,887	3,013	3,107	3,197	3,355
Colusa	411	1,420	1,475	1,525	1,651	1,739	1,812
Contra Costa	40,962	98,986	110,826	101,701	105,381	105,925	110,731
Del Norte	339	1,127	1,282	1,508	1,344	1,437	1,474
El Dorado	4,910	11,010	11,166	11,592	12,025	12,448	13,072
Fresno	17,108	63,538	65,148	66,998	68,560	70,153	71,928
Glenn	592	1,845	1,963	2,001	2,049	2,076	2,164
Humboldt	3,021	9,740	10,172	10,655	11,085	11,493	11,906
Imperial	2,220	9,491	10,164	10,473	9,949	7,461	9,479
Inyo	516	1,970	1,956	1,887	1,783	1,816	1,760
Kern	13,087	51,583	46,163	51,499	51,901	56,068	53,285
Kings	2,581	8,325	8,951	9,110	8,873	9,394	9,668
Lake	2,154	4,556	4,555	4,610	4,635	4,753	4,831
Lassen	366	1,369	1,275	1,494	1,391	1,455	1,551
Los Angeles	460,656	1,280,693	1,182,638	1,139,190	1,123,618	1,140,069	1,142,036
Madera	1,785	4,376	7,777	8,112	8,334	8,771	9,164
Marin	11,640	29,847	31,158	32,212	33,259	35,037	36,947
Mariposa	159	751	860	852	863	968	994
Mendocino	1,734	4,123	6,718	6,986	7,319	7,674	8,341
Merced	4,821	15,752	16,457	16,353	17,864	17,419	18,224
Modoc	195	726	733	789	702	718	732
Mono	730	1,620	1,857	1,782	1,805	1,843	1,887
Monterey	8,952	27,232	28,147	29,637	30,294	32,031	33,725
Napa	3,026	10,997	11,397	11,671	12,058	12,591	13,318
Nevada	1,596	6,772	7,106	7,489	7,705	7,966	8,320
Orange	100,790	266,326	263,291	256,668	258,394	267,539	283,108
Placer	6,099	19,190	19,804	21,018	22,152	23,073	24,877
Plumas	419	1,179	1,452	1,393	1,446	1,612	1,691
Riverside	42,395	101,442	100,987	101,248	100,470	101,026	104,645
Sacramento	33,520	92,601	119,029	120,312	121,027	122,089	127,312
San Benito	1,125	2,555	2,445	2,550	2,536	2,552	2,757
San Bernardino	52,952	61,795	122,948	124,230	127,236	130,511	133,188
San Diego	53,115	118,887	193,143	195,402	195,788	202,003	215,277
San Francisco	53,906	136,249	139,667	130,444	133,975	138,524	152,317
San Joaquin	15,533	57,246	58,568	60,510	61,723	64,201	66,251
San Luis Obispo	6,448	19,909	21,443	21,632	21,954	22,695	23,451
San Mateo	19,405	74,505	76,101	77,125	79,427	83,780	90,783
Santa Barbara	10,724	30,256	31,379	32,042	32,951	34,418	37,224
Santa Clara	58,524	134,577	166,292	166,834	171,152	184,753	209,795
Santa Cruz	5,913	19,444	19,971	20,577	20,727	21,513	22,654
Shasta	2,704	11,896	12,471	12,917	12,485	13,211	13,520
Sierra	143	284	303	310	318	319	345
Siskiyou	900	2,906	3,097	3,408	3,523	3,667	3,720
Solano	15,758	32,384	34,670	37,499	36,571	37,118	38,165
Sonoma	11,709	35,935	37,634	37,654	38,205	39,541	41,504
Stanislaus	5,243	28,201	28,517	29,002	29,206	29,805	30,609
Sutter	1,657	5,968	6,161	6,312	6,620	6,771	6,964
Tehama	924	3,272	3,567	3,760	3,899	4,010	4,136
Trinity	113	393	487	508	539	546	519
Tulare	8,036	27,267	28,703	29,891	30,658	31,806	32,808
Tuolumne	1,267	3,492	3,919	3,862	4,098	4,200	4,306
Ventura	26,523	63,070	68,900	70,154	71,003	70,518	73,269
Yolo	4,364	14,228	15,925	16,735	16,929	16,894	18,332
Yuba	1,321	4,511	4,984	4,980	4,952	5,049	5,775
Total	1,201,900	3,211,995	3,364,512	3,327,654	3,345,080	3,438,527	3,570,913

Source: SCO's Annual Report of Property Taxes for the 1992-93 Through 1998-99 Fiscal Year

Fiscal Year 1997-1998 ERAF Contributions	
Counties	\$ 2,656,218,449
Cities	526,698,062
Subject to swap	3,182,916,511
Special Districts	255,610,808
	\$ 3,438,527,319

Notes to Alternate Plans and the “SMART Formula”

After discussion of the merits and drawbacks of several methods that might be used to reallocate sales taxes, and to offset local governments for the lost property tax revenues associated with the creation of the Educational Revenue Augmentation Fund (ERAF), the following methodology was used for computing the information in Alternatives 1 through 3.

In order to reallocate sales taxes based more on a county’s population, rather than where the sale occurred, the current percentage of sales tax revenues distributed by county, and the percentage of population by county were computed. First, information from the State Board of Equalization’s 1997-1998 Annual Report, the latest report available, was obtained. Sales tax information from Table 21A - Revenues Distributed to Cities and Counties from the Local Sales and Use Taxes, was summarized to provide the total sales tax revenues for counties and cities. This total therefore represents what a county would normally receive on 1% of taxable sales.

Information on population by county was obtained from the Department of Finance’s Population Certification letter dated July 22, 1999. The proportionate statewide percentage of that county’s population to total population was computed by dividing the county’s population by the statewide total population.

After the percentages were obtained for countywide sales tax revenues distrib-

uted and population by county, these percentages were weighted and then multiplied by the total statewide sales tax revenues distributed in fiscal year 1997-1998.

This was done to determine the impact of weighting some of the sales tax revenue distribution on population versus point-of-sale. The percentages were weighted in the following manner; sales taxes by point-of-sale, i.e. situs, were multiplied by 90%, while sales tax distributed by population was multiplied by 10%.

Finally, in order to provide the counties with some relief from the ERAF shift, which first occurred in fiscal year 1992-1993, we allocated \$450 million to these counties based on the percentage of the ERAF shift for the fiscal year 1997-1998. Information from the State Controller’s Office’s 1997-1998 Annual Report of Property Taxes was used in most cases. For the counties not providing the breakdown of the ERAF shift by county and city for 1997-1998, 1998-1999 data was used to estimate the 1997-1998 information.

State Controller Kathleen Connell wishes to extend her heartfelt thanks to all the individuals whose hard work and dedication made this report possible.

S T A T E

M U N I C I P A L

A D V I S O R Y

R E F O R M

T E A M

T A S K F O R C E

Membership

Hon. Richard Alarcón
State Senator

Hon. Doug Balmain
Mariposa Board of Supervisors
Chair of Accountability Subcommittee

Hon. Ed Edelman
Rand Corporation

Len Frank
Pardee Construction

David French
Regional Council on Rural Counties

Mark Gaughan
San Diego Gas & Electric Company

Travis Gibbs, Esq.
O'Melveny & Meyers

Annelle Grajeda
SEIU - Local 660

Hon. Lucy Killea
S. D. International Community Foundation

Pius Lee
California Realty & Land Inc.

Hon. Gloria Molina
L.A. County Board of Supervisors
Chair of Taxes Subcommittee

Dowell Myers, PhD
USC - School of Policy, Planning and Development

Hon. Beverly O'Neill
Mayor of Long Beach

Hon. Julie Partansky
Mayor of Davis
Chair of Land Use Subcommittee

Hon. Judy Pennycook
Monterey Board of Supervisors

Mark Pisano
Southern California Association of Governments

George Popyack
AFSCME

Hon. George Runner
State Assembly Member

Steven Szalay
California State Association of Counties

Jeff Vesely, Esq.
Pilsbury, Madison & Sutro

Tom Winfield, Esq.
Brown, Winfield & Canzoneri, Inc.