

## Why Do Property Tax Shares Among Cities Vary? How Can We Improve?

# Rethinking Property Tax Allocation

The taxation of property is a common means of raising revenue to fund government and community services throughout the world and human history. In California, property taxes are an essential source of revenue to cities, counties, schools, and many special districts. The rules for property tax adoption and administration are set in the state constitution (including Proposition 13), state law, and regulations adopted by the California State Board of Equalization. While many critique California's lack of voter control over the property tax rate, the disparate taxes paid by similar properties or the quizzical behavioral incentives (especially to commercial property owners), the most frustrating and often misunderstood aspect of California's property tax system may be its complex allocations among local governments, and the role of the state Legislature in those rules.

### I. Property Tax Revenue is Administered and Allocated Locally

Property taxes in California are collected by counties and allocated according to state law to cities, the county, special districts, redevelopment agencies and school districts within the county from which they are collected. Property taxes are not a revenue source to the State of California. However, property tax revenues allocated to schools generally offset required funding levels from the state general fund, thus affecting state general fund *spending* levels.

### II. Property Tax is an Essential Tax Revenue Source Historically

The property tax is among the oldest forms of taxation in America, dating back to the colonial period. Prior to 1912 in California, property taxes constituted the largest single source of revenue to the State budget. In 1900, 89 percent of California state taxes were derived from ad valorem property taxes.

But a major change came with the great depression, which so depressed property tax revenues, it forced the state to seek other forms of revenue - diversification if you will - namely the sales and income taxes. Since 1933, the property tax has been a local tax, levied, collected and used by local governments (including schools). In 1930, 78 percent of all city revenues were derived from property tax revenues.

Prior to 1978, property tax was the largest source of general purpose revenue for most cities, followed by the local sales tax and the Vehicle License Fee (VLF). But this varied. There were, even then, some communities that were sales tax magnates who set their property tax rates low. Others with high property values, either due to residential wealth or large amounts of commercial / industrial areas could set low rates and still garner sufficient Tax revenue. Cities (i.e., city councils) had the authority to examine the public service needs of their constituents,

consider revenue projections from their finance staffs, consider what the community would be willing to pay, and increase or decrease property tax rates accordingly.

But Proposition 13 changed all that.

### III. Proposition 13 Was a Seismic Shift of Authority to the State

In 1978, a simple majority of California voters approved Proposition 13, seeking property-taxpayer relief and uniformity, but with far-reaching consequences, some unintended. Proposition 13 reduced property tax revenues by more than half and effectively abolished any local autonomy with regard to the property tax.<sup>1</sup> Local governments still have wide latitude on the spending of the remaining revenues they receive, but the allocation of the tax is controlled by the state Legislature.

Prop13 denies even local voters the power to:

- increase a property tax rate above 1% (except in the case of a G.O. Bond!)
- reallocate property taxes among services if those service are not provided by the same agency.

In subsequent related decisions, the California Supreme Court clarified that Proposition 13 “prevails over the preexisting taxing power” of cities and that the taxing powers of local governments are “derived from the Constitution upon authorization by the Legislature.” The Legislature has retained this authority with no delegation to locals of authority to reallocate property tax revenue, even of “city” services (such as fire, parks or libraries) provided by others. Thus, where once a community could devote more or less property tax revenue to fire services versus libraries versus schools, now all communities are constrained by a system based on decisions made a generation ago when California was a very different place socially, economically and politically.

### IV. The “SB154/AB8 Bailout” Established the Current Allocation System.

Proposition 13 set a single, countywide rate of 1 percent, replacing the numerous individual tax rates set by the various taxing agencies. Using the authority given by Proposition 13, the Legislature, in FY1979–80, was able to shift about \$2.7 billion of annual ongoing financial resources to local governments. In what was intended as a permanent resolution to the issue of how to distribute significantly reduced property tax revenues, the “SB154/AB 8 bailout” [Chapter 282, Statutes of 1979 (AB 8, L. Greene)] reduced school shares of property tax revenues and gave cities counties and special districts greater shares. In return, the state assumed a larger financial responsibility for K-14 schools. The state also increased its share of costs for a number of social service and health programs operated by counties. The state was able to implement the “bailout” in part because of the state’s \$5 billion surplus (about 40 percent of annual revenues) and the \$1 billion-plus annual revenue boost it received from higher personal income taxes due to lower taxpayer deductions for property taxes. As a result, city property tax losses from Proposition 13 were about 28 percent less than they might have been.

Property tax levels for 1978-79 were established by SB154 (1978). In 1979, the Legislature passed AB8, giving each agency the amount of property tax revenue it received in the prior year (the base) and establishing a system of apportioning revenues from the change in assessed valuation among the local agencies serving a property. Pursuant to this law, each county allocated revenues to local agencies based on their average property tax revenue in the three years preceding FY1978-79 (when Proposition 13 was adopted). Each year thereafter, counties have allocated property tax revenues according to 1) the property tax revenues allocated to each agency in the previous year; plus 2) a share of the growth in tax revenues resulting from increases in assessed value in the jurisdiction. Simply put, each agency's share reflects the tax rate of each jurisdiction relative to the rates of other taxing agencies in the jurisdiction.

Cities that have incorporated since Proposition 13 in 1978 received a share of property tax revenues from the share previously going to the county and, in some cases, special districts that previously served the area. As they were not in existence at the time of Proposition 13, these city revenues are not *directly* affected by Proposition 13 or the subsequent SB154/AB8 bailout. But the county and other municipal service providers who served the community prior to incorporation were. Nevertheless, fiscal analyses, conducted at the time of incorporation, are intended to ensure that the new city receives a sufficient share of property tax revenues.

## V. “Tax Equity Allocation” (TEA) for No and Low Property Tax Cities

When Proposition 13 passed in 1978, there were 31 cities that did not levy a property tax (other than for voter approved indebtedness), relying instead on other revenues to fund city services. These were called “no-property-tax-cities.” No-property-tax-cities did not lose tax revenue as a result of Proposition 13 and neither did they receive property taxes under the subsequent SB154/AB8 bailout adjustments.

Other cities (about 60), levied low property tax rates and are known as low property-tax cities. Proposition 13 and its implementing legislation effectively froze property taxes at their existing levels. Cities could not increase their property tax rates to meet changing community service expenses and demands.

In 1987, the Legislature directed county auditors to provide a “Tax Equity Allocation” (TEA), designed to increase the property tax shares of “qualifying cities.” Counties were required to make these adjustments as a condition for receiving new funding for trial courts. Following a precedent set in previous legislation exclusively for the City of Yorba Linda, the Legislature directed counties to transfer tax revenues to the no/low cities from the county shares. “Qualifying cities” are those that incorporated prior to June 5, 1987 and received less than 7 percent of property tax revenues collected within their jurisdiction.<sup>ii</sup>

The TEA property tax shift from counties to no/low cities failed to take into consideration the differing types and levels of services that cities delivered to their residents. In most no/low cities, some core municipal services (fire protection, libraries, parks) are provided by special districts that - as a result - receive property tax revenues that would otherwise go to the city.

## VI. Special Vehicle License Fee (VLF) Allocations to No-Property Tax Cities

In 1981, with the state budget heading into deficit, the Legislature enacted a number of changes to local government revenues, while avoiding reducing the SB154/AB8 bailout of local governments impacted by Proposition 13. The state reduced or eliminated various local government revenue allocations including three subventions the state had been providing to cities and counties:<sup>iii</sup>

- **Liquor License Fees.** Historically, 90 percent of liquor license fees collected by the state were distributed to cities and counties. Beginning in 1981-82, the state retained these fees in the state general fund. The annual loss to local governments in 1981-82 was \$14.8 million, including \$12.1 million from cities and \$2.7 million from counties.
- **Highway Carrier's Uniform Business Tax.** This tax, imposed on all persons and companies operating motor vehicles transporting property on public highways are required to pay a fee of one-tenth of one percent of operating revenues. Historically, these revenues were distributed to cities proportion to population. The annual loss to cities in 1981-82 was \$4.3 million.
- **Financial Aid to Local Agencies (FALA) Fund.** In the 1920s, California began imposing a state income tax on commercial banks. Under the state constitution,<sup>iv</sup> the bank tax is in lieu of all other state and local taxes. However, this law did not impose a state income tax on savings and loans, and did not prohibit a local tax, such as a property tax, business license tax, on savings and loans. Charter cities imposed certain taxes, including personal property taxes, on savings and loan institutions. In an effort to maintain parity between the taxes paid by commercial banks and those paid by savings and loans, the state deducted from savings and loans' state tax bill, the amount paid to municipalities. In 1979, the State abolished the offset and extended the bank in lieu tax to savings and loans, exempting them from all other state and local taxation. To protect cities from financial loss, the state enacted the Financial Aid to Local Agencies (FALA) fund. The elimination in 1981 of FALA caused an annual loss to local governments in 1981-82 totaling \$30.0 million, including \$22.5 million from cities and \$7.5 million from counties.

The 31 no-property-tax-cities which existed in 1978 argued that since they did not receive any assistance from the SB154/AB8 bailout (due to the fact they experienced no loss from Proposition 13), they should not be included in reductions in local government assistance which resulted from the state's inability to continue to finance the bailout. Beginning in 1981, the Legislature appropriated \$2.2 million to offset losses to these cities from the elimination of the three subventions. Beginning in 1984-85, this special allocation was provided by the state from Vehicle License Fee (VLF) revenues. Section 11005(b) of the Revenue and Taxation code was soon expanded to cover any city incorporated prior to June 5, 1987 and received less than 10 percent of the property tax generated within their boundaries in 1987-88.<sup>v</sup> These cities received a supplemental VLF amount equal to the amounts they would have received from the Highway Carriers Uniform Business License Tax, Liquor License Fees and Financial Aid to Local Agencies had these subventions not been abolished. Seventy-seven "low and no" property tax cities qualified for payments under these provisions.

Since the VLF-Property Tax Swap of 2004 (see below), this special allocation is effectively a part of the Property Tax in Lieu of VLF (VLF Adjustment Amount) received by these cities.

**Low Property Tax Cities**  
**Special Supplemental VLF – Now Property Tax Share per 2004 Swap**  
**by Sec 11005(b)(1)**

|              |                     |                       |                  |
|--------------|---------------------|-----------------------|------------------|
| Agoura Hills | Encinitas           | Mammoth Lakes         | Rosemead         |
| Angels Camp  | Fortuna             | Monte Sereno          | San Dimas        |
| Artesia      | Foster City         | Moorpark              | San Marcos       |
| Arvin        | Grass Valley        | Moraga                | San Ramon        |
| Bell         | Hawaiian Gardens    | Moreno Valley         | Santa Fe Spring  |
| Bellflower   | Hercules            | Nevada City           | Saratoga         |
| Bradbury     | Hidden Hills        | Norwalk               | Scotts Valley    |
| Camarillo    | Indian Wells Irvine | Novato                | Signal Hill      |
| Capitola     | La Canada           | Orinda                | Simi Valley      |
| Carson       | Flintridge          | Palm Desert           | Solana Beach     |
| Cerritos     | La Mirada           | Palmdale              | South El Monte   |
| Clayton      | La Puente           | Paramount             | South Gate       |
| Colma        | La Quinta           | Pico Rivera           | Temple City      |
| Commerce     | Lafayette           | Pleasant Hill         | Thousand Oaks    |
| Cudahy       | Lakewood            | Rancho Cucamonga      | Vernon           |
| Cupertino    | Lancaster           | Rancho Mirage         | Victorville      |
| Danville     | Lawndale            | Rancho Palos Verdes   | Walnut           |
| Dublin       | Lomita              | Rio Dell              | Westlake Village |
| El Segundo   | Los Altos Hills     | Rolling Hills         | Westminster      |
|              |                     | Rolling Hills Estates | Whittier         |

## VII. Educational Revenue Augmentation Fund (ERAF)

In 1992, facing serious budget deficits, the California Legislature and Governor Pete Wilson instructed county auditors to shift the allocation of local property tax revenues from local government to “educational revenue augmentation funds” (ERAF), directing that specified amounts of city, county and other local agency property taxes be deposited into these funds to support schools. School funding from the state General Fund was reduced by a commensurate amount so that the losses to cities, counties and special districts equated to a gain for the state general fund.<sup>vi</sup>

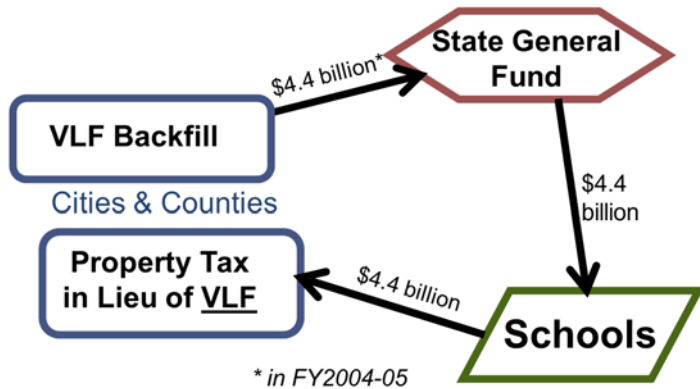
The first ERAF shift, for the 1992-93 budget year, included a nine-percent shift of each city’s property tax revenues. This is a permanent reduction to each city’s base property tax apportionment and the largest component of the 1992-93 shift for cities.<sup>vii</sup> The following year, the Legislature exacted further deeper ERAF shifts from cities, counties and special districts. Effective beginning the 1993-94 budget year, an additional amount based on each city’s “SB154/AB8 bailout” following Proposition 13 was permanently shifted to ERAF. Cities that did

not levy a property tax when Proposition 13 passed in 1978 (including those that incorporated after 1978) did not participate in the bailout, and consequently were not affected by this second phase of ERAF. Others with low property tax shares received proportionately smaller Proposition 13 losses, smaller SB154/AB8 bailouts, and smaller ERAF shifts.

**VIII. The VLF – Property Tax Swap (2004) – More Property Tax for Every City**

The state constitution requires that the Vehicle License Fee (VLF) be allocated to cities and counties. In 1998, the Legislature began offsetting the 2 percent Vehicle License Fee (VLF) tax rate, providing a “backfill” to local governments, offsetting the taxpayer rate for an effective tax cut to registered vehicle owners.

In 2004, the Legislature approved a swap of VLF for property tax as a part of a state-local budget agreement. The state general fund backfill payments to cities and counties were eliminated. The VLF rate was reduced from 2 percent to 0.65 percent, its effective rate with the prior backfill / offset system. The reduction in VLF backfill to cities and counties (approximately \$4.3 billion) was replaced with a like amount of property taxes, dollar-for-dollar. Subsequent to the FY2004–05 base year, each city’s (and county’s) property tax in lieu of VLF or “VLF Adjustment Amount” increases annually in proportion to the growth in gross assessed valuation in that jurisdiction.



VLF Adjustment Amounts are transfers from the school property tax shares and are in addition to other property tax revenues. Schools are held financially harmless from the swap because the state compensates with general fund support.

The 2004 VLF-Property Tax Swap effectively made permanent the special VLF allocations to no-property tax cities provided as compensation for the repeal of the three subventions in 1984.

**IX. Proposition 1A (2004) Protects the Property Tax for Local Governments**

With the passage of Proposition 1A in November 2004, the voters of California constitutionally protected major city, county and special district revenues, including property taxes. With regard to local property taxes, Proposition 1A prohibits the Legislature from reducing the share of property tax revenues going to the cities, county and special districts in any county, and shifting those shares to the schools or any other non-local government function. However, the Legislature may alter the allocation of property taxes among cities, counties and special districts within a county with two-thirds approval in each house.<sup>viii</sup>

Proposition 1A did not provide local governments with any new revenue nor reduce or alter the ERAF I and II shifts.



## X. Why Do Shares of Property Tax Differ Among Cities?

Some people wonder why the property tax shares for their city or county are lower than their neighbors. There are many reasons, some quite rational and some arguably unjust, why similar local governments differ in the amount of property tax revenues they receive.

Under the SB154/AB8 apportionment formulas established by the Legislature following the passage of Proposition 13, local property tax shares depend on the relative pre-1979 tax rates of the county, city, special districts, and schools that serve a particular area. This has, in effect, calcified property tax shares among local agencies based on conditions and choices made in the 1970s. Today, more than forty years later, four major factors underlie the differences in property tax shares among cities.

- 1. Local political philosophy regarding taxation and the role of government prior to Proposition 13.** More fiscally conservative areas of the state generally adopted lower tax rates. Depending on how this affected the relative tax rates of different local agencies, this contributes to a lower allocation of the property tax today.

This political orientation primarily concerned tax levels, and was generally considered on an agency by agency basis. That is, the elected officials of each individual public agency, looking through their own political philosophies, would determine property tax rates for their agency. No centralized decisions were made regarding the relative priority and funding of these different taxing services. By fixing the local tax rate at 1 percent, AB8 in effect made permanent these historic decisions regarding taxation levels.

- 2. Differences in property values.** Property tax rates and shares are not *directly* affected by assessed valuation. However, prior to Proposition 13, a city with relatively high property values could garner adequate levels with a lower rate or share compared to others. Yet, in the over forty years since, the differences in property values among communities have changed. A property tax rate that made sense based on the assessed values in 1978, may not provide adequate revenue twenty or forty years later if the area's property values have not increased relative to others.

- 3. Differences among communities in service needs.** Prior to Proposition 13, local agencies set their taxing rates at levels they believed necessary to respond to the service demands in their communities. An area with a higher crime rate might seek more revenues than an agency that could safely provide a lower level of law enforcement service. Larger urban areas employ full time professional firefighters, but smaller rural communities can provide adequate fire protection with less costly volunteer fire services.

But the service demands of communities change over time. Rural areas become developed and populated into urban and suburban communities. Societal trends in crime, technology and other areas create public service needs differently in different communities. Yet the current property tax allocation is based on the world that existed in nineteen-seventies, fifty years ago.

**4. Differing service responsibilities among cities.**

All cities are not created equally. The obvious size/population differences aside, cities differ in what they do - in the services for which they are financially responsible. This has nothing to do with whether a city chooses to contract out a service. It concerns financial responsibility: Does the city have to pay for the service?

A public agency that provides police, planning, fire, and library services requires more resources than one that provides only police and planning services. A community served by a fire district has one more agency sharing the allocation of property tax revenues than an area where the city provides that service. Thus, differences in service responsibility explain much of the differences in property tax rates among cities.

- ✓ Less than one-third of California cities are "full service" (but full-service cities serve a majority of the state's population);
- ✓ In non-full service cities, some basic municipal services are provided instead by special districts or the county.
- ✓ Nearly 1/3 of cities aren't responsible for fire.
- ✓ Nearly 2/3 of cities aren't responsible for library.

Fire and library are the most common non-enterprise city services provided by special districts within incorporated cities. In most full-service cities, the cost of providing fire service alone eats up the entire property tax revenues of the city and more. So in a city that's not responsible for fire service, any property tax revenue they get could be money ahead compared to their full service neighbor.

When non-school, non-county property tax shares are compared among cities, the shares going to the full palate of basic municipal services in full service cities are generally lower than the combined shares going to basic municipal service in non-full service cities. This is primarily the result of Tax Equity Allocation formulas which increased all city property tax shares, regardless of service responsibility, to 7 percent.<sup>ix</sup>

The most significant factor in explaining the differences among city property tax shares is that *service responsibilities differ*. When we take this into account, many of the perceived disparities in property tax share disappear.

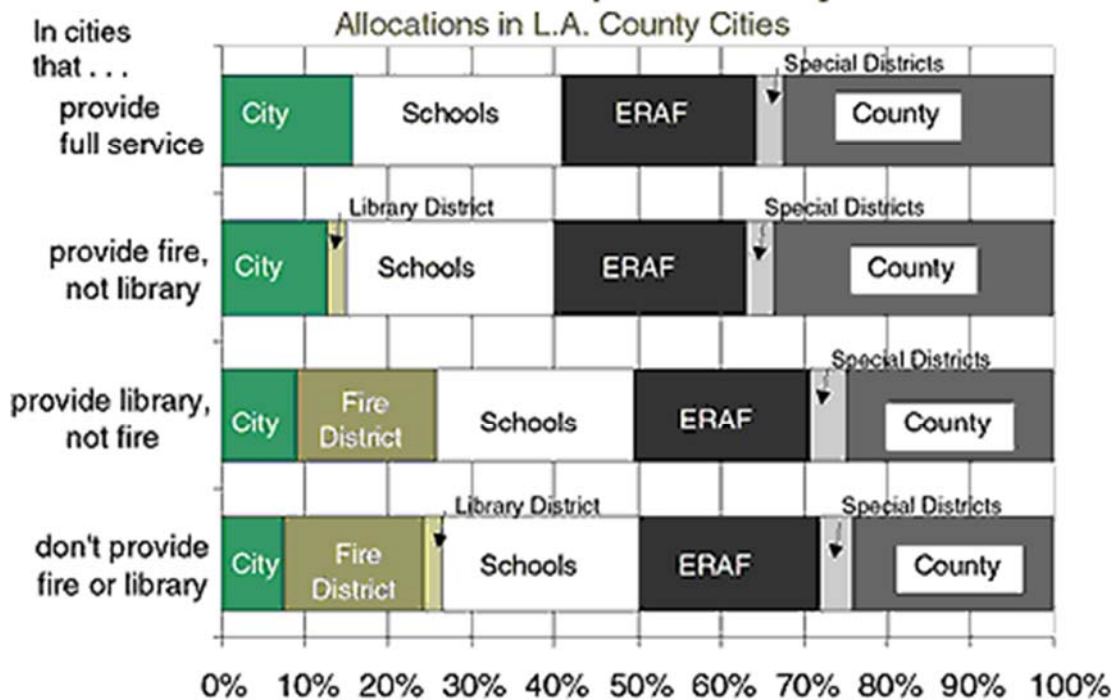
For example, the City of Covina in Los Angeles County receives less than 15 percent of the 1 percent property tax in its community. It is a full-service city, responsible for library, police, etc. - and fire protection. Across the county, the City of Lakewood is not responsible for fire services. In Lakewood, the Los Angeles Consolidated Fire Protection District gets 18 percent of the property tax share, just for providing fire service. Add to that the 6 percent Lakewood gets and 2 percent that

goes to the Library District, and you have over 26 percent going to the same collection of services that get less than 15 percent in Covina.



Still, it would be an oversimplification to conclude based on these facts, that these differing shares are unfair. For example, a lower rate in Covina might be sufficient to garner a comparable amount of revenue taking into account differing property values and commercial / industrial properties.

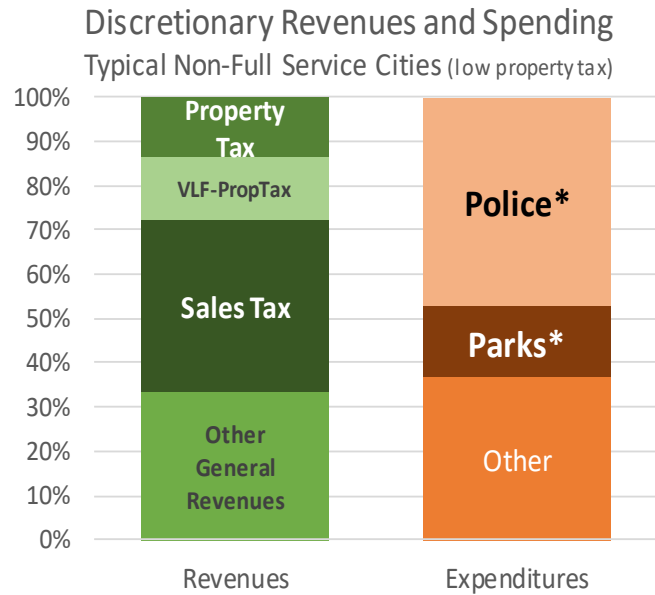
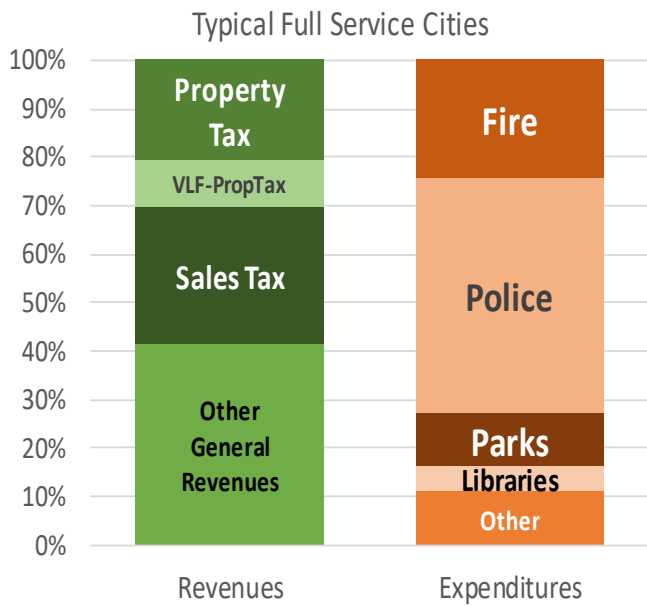
## Property Tax Shares Vary With Service Responsibility



When the total of all property tax shares going to core municipal services (police, fire, parks, library, planning, streets) is compared, there is actually less total property tax share going to these services in full service cities than in “low property tax” cities.

Source: Michael Coleman analysis of Los Angeles County Auditor Tax apportionment factors.

### Discretionary Revenues and Spending



\*Fewer than 1/4 of these cities are responsible for library services. Fewer than 1/3 are responsible for fire services.

**Source:** Michael Coleman calculations from California State Controller reports.

## XI. What is a Fair Allocation of Property Tax?

As one imagines solutions to the property tax allocation question, the natural draw is to an ideal formula, the right number for each local agency based on logical computed factors. Should each city get the same percentage share of the property tax collected within its jurisdiction?

- But... not all cities are responsible for providing the same menu of services. A full service cities has a greater spending need that a city in which library or parks or fire services are funded and provided by a special district. In these cases, the responsible district needs a portion of the property tax revenue.

So perhaps all full service cities should get the same share; and all cities that are full service except for fire, an adjusted lesser standard amount with some shares instead going to the fire districts. Likewise, all cities not responsible for fire or library should receive a lesser standard amount with portions going to fire and library districts instead.

- But... the same percentage share generates vastly different amounts in different communities depending on property value. Residential wealth and property values,

**Per Capita Revenue Comparisons**  
 A common method of comparing revenues is per capita. But while this can be informative, per capita property tax comparisons also have inherent flaws in that they don't take into account:

- differences in service responsibility,
- differences in needs/ service demand,
- differences in non-populated (i.e. commercial / industrial) service areas.

Moreover, property tax revenues of many cities are substantially reduced by redevelopment (successor agency) tax increment.

the amount of commercial/business property, the amount of tax exempt properties such as state or federal government facilities.

- And... one community may want to provide more funding for library services and less to fire services, another may prefer more parks services. Static formulas do not allow for these differences, or that community needs and preferences change over time.

The Legislative Analyst's Office (LAO), like many other fiscal reform groups who have studied this issue determined that "no perfect solution exists." LAO noted that this sort of search for a master formula is essentially another top-down approach that doesn't make the system more responsive to changes in local priorities and needs. Uniform rates are by their nature arbitrary and may not adequately consider the complex web of varying local conditions.

This rigid system exists because of the authority that Proposition 13 gave to the State Legislature and because the Legislature has not chosen to delegate that authority. Prior to Proposition 13, cities and other local governments could chose to lower or increase tax rates and allocations among various local services.

## **XII. The Real Problem: Fragmentation of Governance, Lack of Local Choice**

The root of the problem is how to empower communities with the authority they need to allocate revenues according to their particular needs and preferences – which may be different than other communities. The problem for non-full service, low-property tax cities is not so much a lack of money or of inequity, it's that we have a local property tax apportionment system that fragments local governance: no local authority exists to allocate revenues among the core municipal services to improve efficiency and to better match local service level preferences.

The problem is not that rates differ; it's that they are based on a 35-year-old snapshot. A side-effect of Proposition 13's tax limitation victory is that it took away local control of the rate and the local allocation of revenues so communities can no longer affect their property tax revenues in response to differences in property values, service demands, and willingness to pay.

Good local governance requires:

- ✓ Ability to set priorities across a broad spectrum of needs.
- ✓ Ability to coordinate programs for efficient service delivery.
- ✓ Ability to fund these programs adequately with revenues that are rationally tied to the program.
- ✓ Ability to change priorities, funding allocations, and service delivery methods as circumstances change.

## **XIII. California's Balkans: Fragmented Local Government**

For all their good intentions, many local elected officials are hampered in their efforts to provide efficient, responsive local public services by a complex fragmentation of local services and finances. In many communities numerous overlapping special districts split responsibilities with the city and county. Tax allocations may be out of step with current priorities, but no one has the local authority to change things.

California cities are generally well governed. But in many California localities, municipal public service responsibilities and finances are divided among dozens of independent local agencies. Property tax allocations are fixed, based on circumstance more than two decades old. Because of this fragmentation, the general purpose government - the city - is hampered in its policy choices as to priorities, funding and service delivery. The allocation of tax revenues is less efficient, less transparent, less responsive, and less accountable to citizens than it could be.

Because of this balkanized property tax allocation, based on nearly 40 year old relative shares, citizens

- ✓ Cannot reallocate resources as their community changes, as new challenges arise, and as needs and priorities change.
- ✓ Face unnecessary added pressures for tax increases where the need for funding might be solved by a more efficient allocation of revenues among the local agencies serving the area.

#### **XIV. Property Tax Reform is Essential to Improving Local Government Services**

In 1996, the California Constitutional Revision Commission recommended each county establish a “charter revision commission” that would have the power to – among other things – reallocate property tax shares among local governments.

One way to provide local agencies that believe they have inequitably low property tax shares is to providing them with capacity to increase (with voter approval) their property tax rates. The LAO 2000 AB8 report contained a version of this concept under Alternative II, suggesting that the Legislature cut property tax levels by the amount (or a portion) of ERAF. An alternative approach would be to amend Article XIII of the California Constitution to allow local voters to increase the ad valorem property tax above 1 percent.

Local authority to alter property tax allocations could be provided by giving cities the ability to reallocate property tax shares going to all municipal functions including police, fire, libraries, parks, water, sewer, transit, etc. Given the authority to alter revenue allocations, cities would also have to assume the responsibility for the services. But they could continue to contract with special districts or others to provide the services on true contracts.

LAO suggested something like this approach in a 2000 report on property tax allocation. Essentially, LAO suggested that the property tax be boiled down to a school share and a non-school share and that local general purpose governments (cities and counties) be given authority to make allocations from the non-school share. In effect, *all* cities would become "full service," responsible for all municipal services (fire, police, parks, library, etc.). Special districts could continue to be service providers under arrangement with cities and counties, but would no longer be “taxing entities.” Cities could contract out services or choose to allocate parts of their property tax share to redevelopment or special districts. LAO argued that this would improve local control, provide better land use development incentives, and improve local governance.



Reforming the property tax apportionment system is central to the reform of California's state and local governance system and the real answer is not one-size-fits-all formulas but more local control, what Governor Brown has termed “subsidiarity.”.

The power to reallocate property tax revenues among basic municipal services (non-school, non-countywide) should be consolidated in a single agency along with the responsibility for the provision of all basic municipal services: cities and, in unincorporated areas, counties. A special district is sometimes the most efficient way to provide a local service, but it should do so under contract with a city or a county, not as an independent entity with a locked-in property tax share. In cases where the community determines that a special district is the most efficient and effective service provider, the city or county may delegate services to the special district under contract. Consolidating local government finance and service responsibility into general purpose cities and counties will improve accountability and local government responsiveness to changing needs.

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**DeFraging Local Governance and Property Tax Allocation**

For a more efficient property tax allocation, more responsive to the needs and priorities of communities, cities and counties should have the primary responsibility for core municipal services and related property tax share as follows. Services could be provided by another agency under contract.

| <u>Cities</u>        |                 | <u>Counties</u>        |                    |
|----------------------|-----------------|------------------------|--------------------|
| ✓ Land Use Planning  | ✓ Lighting      | ✓ Sheriff              | ✓ County Clerk     |
| ✓ Police             | ✓ Roads         | ✓ Courts               | ✓ Social Services  |
| ✓ Fire and emergency | ✓ Water         | ✓ District Attorney    | ✓ Health, Hospital |
| medical service      | ✓ Sewer         | ✓ Auditor / Controller | ✓ Environmental    |
| ✓ Parks & Recreation | ✓ Flood Control | ✓ Tax Collector /      | Management         |
| ✓ Library            | ✓ Etc.          | Assessor               | ✓ Vector Control   |
|                      |                 |                        | ✓ Etc.             |

- ◆ Simplifies the tax structure, makes it more comprehensible to citizens.
- ◆ Aligns tax revenues to match service responsibilities.
- ◆ Increases local autonomy and flexibility to respond to unique local needs and priorities.
- ◆ Reduces waste, increases efficiency and effective service delivery by enabling communities, through a centralized, democratically elected city council or board of supervisors to determine priorities and allocate resources accordingly.
- ◆ Improves government accountability to citizens by clarifying public service responsibilities and linking them to tax revenues.
- ◆ Consolidates the responsibility and financing of local government services, but preserves and enhances local choice as to the most efficient and effective service delivery as determined by the community. Encourages consolidation and innovation in the public interest.

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<sup>i</sup> The voters of California amended Proposition 13 in 1986 with the approval of Proposition 46 which restored the authority of local agencies, with two-thirds voter approval, to enact a property tax rate override to pay for bonded indebtedness issued for the acquisition or improvement of real property.

<sup>ii</sup> Pursuant to provisions of the Trial Court Funding Act of 1987 (SB709, Lockyer), each qualifying no/low city was to receive a phased-in 10% share of property tax revenues generated within its boundaries. In 1988, the Legislature modified this to 7% (AB 1197, W. Brown). Revenue and Taxation Code §98-§98.4 contains special provisions for no/low cities in Los Angeles, Orange, San Mateo, Santa Clara, and Ventura counties.

<sup>iii</sup> The three subventions were referred to in the Capitol as “the three little pigs.”

<sup>iv</sup> Article XIII, section 27 of the California State Constitution.

<sup>v</sup> Chapter 448, Statutes of 1984

<sup>vi</sup> In an effort to cushion the impact of the ERAF shifts on local public safety programs, the California Legislature and Governor Wilson in 1993 submitted to the voters a proposal for a new half-percent sales tax to be dedicated to local public safety including sheriff, police, fire, county district attorneys and corrections. Proposition 172, the Local Public Safety Protection and Improvement Act of 1993, was approved by 58 percent of the voters.

The Proposition 172 half-percent sales tax actually replaced a prior half-percent sales tax for public safety imposed by the Legislature and Governor Wilson for the FY 1992–93 year. That sales tax, also intended as a mitigation for ERAF, replaced a half-percent state sales tax for earthquake insurance. Consequently, taxpayers saw no net increase in their overall tax burden from Proposition 172.

The State Board of Equalization apportions Proposition 172 sales taxes to each county based on its proportionate share of statewide taxable sales. Mindful of the substantially larger proportion of ERAF paid statewide by counties than by cities or special districts, legislative leaders in 1992 initially considered allocating all Proposition 172 proceeds to counties only. But they realized the success of Proposition 172 with the voters would be enhanced with the support of city officials, police and fire chiefs, police officers and city firefighters, so a portion – amounting to about 5% of collected revenues - was allocated to cities. Government Code §30051 requires each county auditor to allocate the revenues in the county Public Safety Augmentation Fund (PSAF) to the county and each city in that county based on their proportionate share of net property tax loss due to ERAF as defined. For the purposes of allocating PSAF revenue, an agency’s “net property tax loss” is defined as the that agency’s FY 1993–94 property tax loss due to phase II of ERAF. As described previously, phase II of ERAF is based on each agency’s estimated receipt of property tax revenues under the SB154/AB 8 bailout of 1980. Cities that received no property tax or that did not exist in 1980 are not affected by this phase of ERAF and consequently are ineligible for Proposition 172 revenues.

Individual agency losses to the phase II ERAF property tax shifts are tied to property tax revenues received by each agency in the post-Proposition 13 SB154/AB8 bailout. Because the intent of Proposition 172 has always been to mitigate the impacts of the ERAF property tax shifts on public safety services, cities that were not impacted by this phase of the shift do not receive Proposition 172 revenues.

<sup>vii</sup> An additional smaller reduction, applicable only for 1992/93, was determined by multiplying the given population of each city by \$1.65.

<sup>viii</sup> Proposition 1A also contained provisions allowing the state to borrow up to 8 percent of city, county and special district property tax revenues in one year under specific conditions. The Legislature invoked this option as a part of the 2009 Budget Act. The loan, used to finance annual operations in FY2009–10 was fully repaid with interest according to law in June 2013. Proposition 22 (2010) eliminated this property tax loan option.

<sup>ix</sup> TEA cities typically commonly receive about 6.3% or a bit less due to the application of ERAF I (a 9% of share reduction) and ERAF II (based on amount of benefit from the Prop13 SB154/AB8 bailout).