March 14, 2014

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SB56(Roth) and AB1521(Fox): Remedy for City Incorporations and Annexations From Impacts of SB89(2011) and VLF-Property Tax Swap

Problem/Background

Virtually all annexations of urbanized areas and new city incorporations have been made financially unfeasible by the loss of huge amounts of revenues that previously would have gone to these areas. This is directly contrary to healthy urban planning and undermines sustainable and compact growth policies.

The state Vehicle License Fee has been a significant source of general purpose revenue to cities since 1935 when it was established in lieu of the taxation of motor vehicles in the local property tax system. Section 15 of Article XI of the California Constitution requires that these revenues be allocated among cities and counties.

The VLF-for-Property-Tax swap of 2004 reduced city VLF allocations by about 90% and compensated with new property tax share, but the swap does not provide compensating "property tax in lieu of VLF" (PTIL-VLF) for

- new cities incorporating after 2004 or for
- annexations to cities where there is pre-existing development.

AB1602(2006) established special allocations from city VLF to mitigate this problem but these funds were deleted in 2011 when the Legislature took all city VLF revenues to fund state law enforcement grants which had previously been funded by the State.

Remedy: Property Tax In Lieu of VLF for New Cities and Annexations

SB56(Roth) and AB1521(Fox) will provide new[1] cities and annexations with PTIL-VLF like other cities. For a city incorporating after 2004 (including the four existing new cities in Riverside County), a formula in statute will establish a base year PTIL-VLF. In subsequent years the amount will be adjusted according to the same rules applied to other cities. For a city annexing inhabited area, the added assessed valuation in the annexed area will be included in the annual calculation of a city's growth in PTIL-VLF.

Important Points

- ✓ This solution supports state Local Agency Formation Commission's (LAFCO) policies to steer urban development away from sensitive habitats and prime farmland. It supports state policies for achieving sustainability, greenhouse gas reduction, smart growth, infill and transit-oriented development.
- ✓ These changes will have no effect on realignment or state law enforcement grant funding.
- ✓ This is not new money for cities. The proposal will restore funds to cities that incorporated or annexed urban areas after 2004, revenues that
  - existed for new cities and annexations prior to 2004,
  - were omitted in the VLF-for-Property-Tax swap of 2004,
  - were restored with a special allocation from the VLF in 2006 (AB1602 Laird)
  - were wiped out when city VLF funds were taken to pay state law enforcement grants previously funded by the state general fund (SB89-2011).

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[1] Incorporations and annexations after 2004 – the year of the VLF-Property-Tax swap.

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State Policy Disconnect: Fiscal Shifts Imperil New City Incorporations and Annexations of Developed Areas

The state Vehicle License Fee has been a significant source of general purpose revenue to cities since 1935 when it was established in lieu of the taxation of motor vehicles in the local property tax system. Section 15 of Article XI of the California Constitution requires that these revenues be allocated among cities and counties.

In 2004, the California Legislature approved a VLF for property tax swap as a part of a state-local budget agreement that also brought Proposition 1A to the ballot. The legislation eliminated a state general fund backfill to cities and counties that had, since 1998, paid cities and counties for their revenue loss from the Legislatures VLF rate cuts. But the 2004 swap legislation failed to provide compensating property tax revenues to annexations and new incorporations. The substantial revenue loss effectively halted new incorporations and annexations of inhabited areas.

In 2006, the Governor signed AB1602(Laird) which provided special allocations, carved from the remaining city VLF revenues, to new incorporations and annexations. Since then, four cities incorporated and 144 cities annexed inhabited areas with the understanding that these essential revenues would help fund municipal services.

In 2011, in conjunction with a hastily crafted annual budget bill, the Legislature passed SB89 taking these constitutionally guaranteed revenues and directing their use to fund state law enforcement programs which had previously been funded by the State.

The fiscal viability of new cities - the four that have incorporated since 2004 as well as any others in the future - has now been thrown into peril.

Virtually all annexations of urbanized areas and new city incorporations have been made financially unfeasible by the loss of huge amounts of revenues that previously would have gone to these areas. This undermines state policies intended to steer urban development away from sensitive habitats and prime farmland and achieve sustainability, greenhouse gas reduction, smart growth, infill and transit-oriented development.

$ Impact	FY2011-12	FY2012-13	FY2013-14
New Incorporations	16,046,103	15,596,942	14,924,957
Annexations	4,316,095	4,531,899	4,758,494
Total	20,362,197	20,128,841	19,683,452

- The VLF-for-Property-Tax swap of 2004 reduced city VLF allocations by about 90% and compensated with new property tax share.
- The 2004 swap does not provide compensating property tax in lieu of VLF for future new cities or for annexations to cities where there is pre-existing development. **The financial loss to these cities is substantial: most new cities (after 2004) are not fiscally viable without a remedy to these losses. In most cases, for cities considering annexing developed residential areas, the cost of serving area will substantially exceed the added revenues.**
- AB1602 was signed into law in 2006 to address these problems by providing special allocations from city VLF revenue to annexations and new incorporations after 2004.[1]
- As a part of the 2011 budget bill, the Legislature took all city VLF revenues, including the special allocations, instead directing their use to fund state law enforcement grants which had previously been funded by the State.

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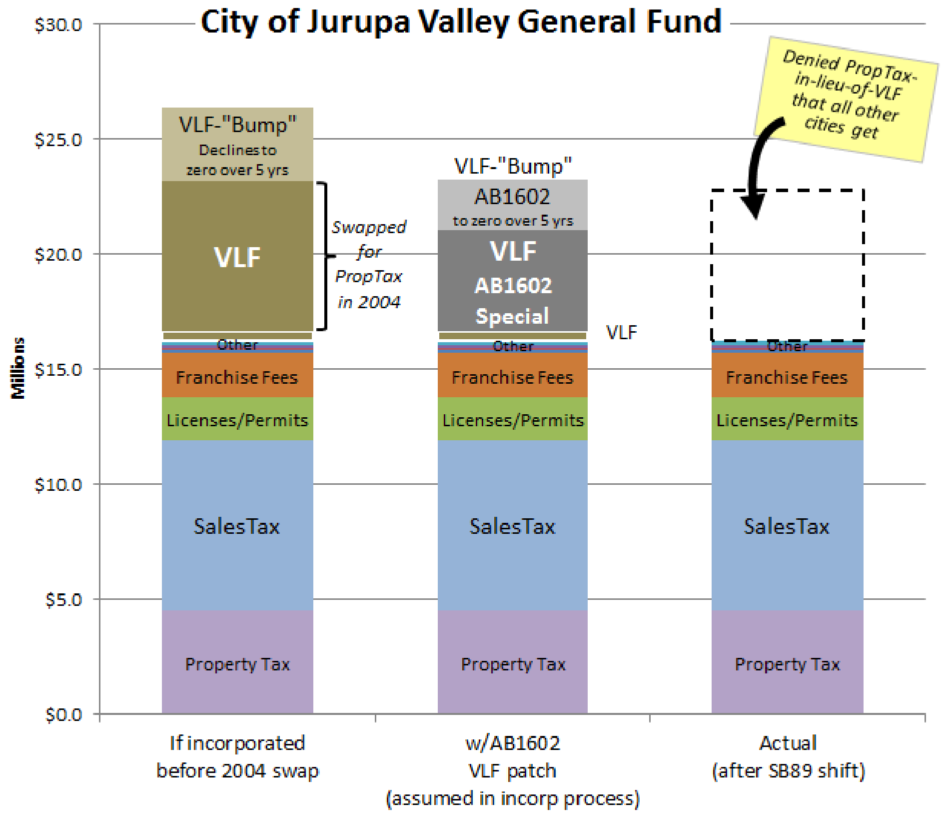
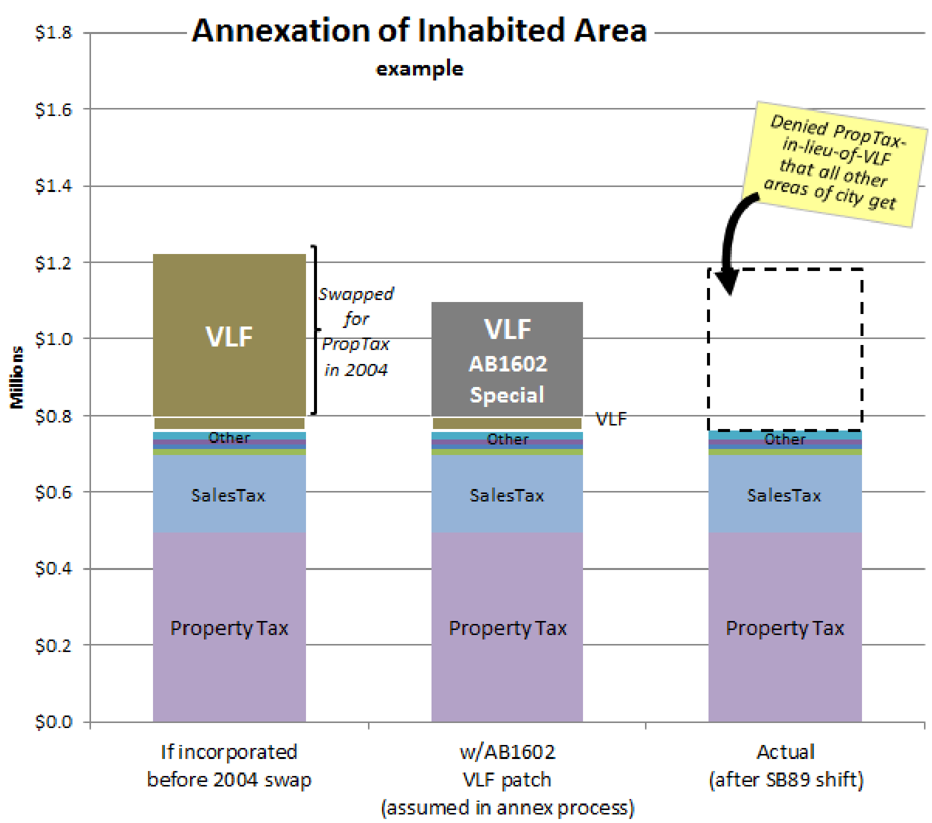


If the City of Jurupa Valley had incorporated under the VLF rules as they were before 2004 the city would be receiving $6.5 million in annual VLF revenues PLUS a declining temporary bump for five years. Under the 2004 swap, the $6.5 million would now come to them as additional property tax. But there are no provisions to give Property Tax in lieu of VLF to a new city after 2004.

AB1602 patched this problem with a special VLF allocation, but that was wiped out by the SB89 shift of VLF to fund law enforcement grants previously paid by the state general fund.



Under the pre-2004 rules, an inhabited annexation brought additional per capita VLF to the annexing city. But the VLF swap of 2004 denied any additional property tax for existing residents/development. This generally made annexation of developed areas fiscally unviable – contrary to state and local policy objectives.

AB1602 patched this problem with a special VLF allocation, but that was wiped out by the SB89 shift of VLF to fund law enforcement grants previously paid by the state general fund.

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