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FROM *THE 1993-94 BUDGET: PERSPECTIVES AND ISSUES*

LOCAL GOVERNMENT PROPERTY TAX TRANSFER

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Local Government Property Tax Transfer

Budget Proposes Another Major Reduction in Local Government Property Taxes

Summary

Property taxes are the largest source of general purpose revenue available to local governments. Cities, counties, special districts, and redevelopment agencies depend upon these revenues to provide a wide variety of programs and services to California residents.

Due to the state's severe fiscal condition, the Administration proposes to shift $2.6 billion in local government property tax dollars to K-14 districts—and reduce state support for public education by the same amount.

In the following pages, we discuss (1) the impact of the proposed property tax shift on local government revenues and programs, (2) the ability of local governments to raise revenues to offset property tax losses, and (3) the impact of the transfer of property taxes on land development proposals.

We conclude that the proposed property tax transfer inevitably will reduce the level of services provided under traditional municipal programs, such as police and fire protection, and that local government revenue sources will not be sufficient to offset the property tax losses.

LOCAL GOVERNMENT PROPERTY TAX TRANSFER

Property taxes are the largest source of general purpose revenue available to local governments. Cities, counties, special districts, and redevelopment agencies depend upon these revenues to provide a wide variety of programs and services to California residents.

Recognizing the important role property tax revenues play in local government finance, the Legislature acted in 1979 to offset substantially the property tax losses local governments experienced as a result of Proposition 13. Specifically, the Legislature adopted a permanent fiscal relief mechanism which (1) shifted about $800 million of school and community college (K-14) district property tax revenues to cities, counties, and special districts (the so-called "AB 8" shift), and (2) assumed financial responsibility for approximately $1.3 billion of county health and welfare program expenses, thereby reducing financial strain on county general tax revenues. The property taxes shifted from schools to local governments were offset by higher allocations of state aid to K-14 education. Thus, the cost of the Proposition 13 "bailout" program for local governments (excluding schools) was about $2.1 billion in 1979-80.

Proposal

Due to the state's severe fiscal condition, the Administration indicates in the budget document that it is eliminating the Proposition 13 "bailout" of local governments. Specifically, the budget proposes to shift $2.6 billion in local government property tax dollars to K-14 districts in 1993-94. This shift would be *in addition* to the permanent redirection of $1.1 billion in property tax revenues to K-14 districts in the current year.

Figure 8 shows the allocation of property tax revenues between local governments and schools in 1991-92, 1992-93, and proposed in the budget for 1993-94. It is important to note that, although Figure 8 shows that K-14 districts would receive *more* property tax dollars under the budget proposal, total revenues for K-14 education *would not* increase. This is because the Administration proposes to *decrease* state funding for K-14 education on a dollar-for-dollar basis.

Figure 9 sets forth the details of the Administration's property tax shift proposal. As the figure indicates, the budget document does not state how almost $2.1 billion of the proposed $2.6 billion property tax shift is to be distributed or accomplished. Instead, the Administration intends that such a plan be developed collaboratively between the state and local governments.

Figure 8

Allocation of Property Taxes Between Local Government and Schools 1991-92 Through 1993-94

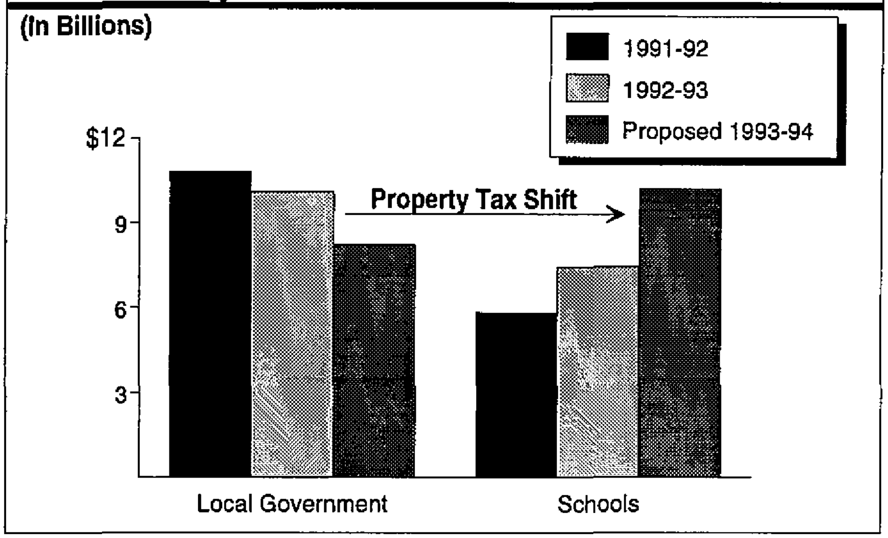


Figure 9

Components of the Proposed Property Tax Transfer

(In Millions)

Local Government Agency Affected	Amount Shifted to Schools	Methodology
Cities, counties, and special districts	$2,075	Unspecified.
Redevelopment agencies	200	Require transfer of funds in an amount equal to 16 percent of property tax increment.
Redevelopment agencies	100[a]	Limit allocation of property increment to amount needed to pay debt service.
Enterprise Special Districts	150	Eliminate entire property tax allocations for enterprise activities, except transit and hospitals.
Counties	70	One-time reduction in county property taxes to reflect projected increase in federal SLIAG monies.
Total	**$2,595**	

[a] This budget proposal would also shift $80 million from redevelopment agencies to counties, cities, and special districts.

Issues for Legislative Consideration

The magnitude of the proposed revenue transfer, the lack of a plan by the Administration, and the complexity of local government finance make this budget proposal one of the most difficult the Legislature will consider this year. We outline some of the important issues for legislative consideration below.

Impact of Budget Reduction On Total Local Government Revenues

The cumulative effect of the current-year and proposed budget-year property tax transfers would be to shift 31 percent of local government property tax revenues to K-14 districts. As Figure 10 indicates, this property tax shift represents a loss of about 4.1 percent of *total* local government revenues in the budget year—or a total of 5.8 percent over the two-year period.

While the percentage reductions shown in the figure may appear lower than reductions sustained recently by many state agencies, our analysis indicates that, in some cases, these funding reductions are *not* comparable. This is because the state has greater ability than some local governments to reduce expenditures. About 88 percent of all county expenditures, for example, are *required* by state or federal governments, and the counties have little control over this spending. Our analysis indicates that counties have discretion over the expenditure of only about $3.1 billion statewide. The current-year property tax shift, therefore, represents a 16 percent reduction in county discretionary spending. The proposed property tax shift (depending on the share allocated to counties) would bring the cumulative reduction in county discretionary spending to *50 percent or more.*

Role of Local Government in Resolving State's Fiscal Crisis. Despite the magnitude of this proposed local government revenue transfer, our review indicates that this does *not* constitute elimination of the Proposition 13 "bailout" to local government, as suggested by the Administration.

Specifically, the budget proposes to shift a total of $2.3 billion from agencies that benefitted from the Proposition 13 fiscal relief program (cities, counties, and special districts). As we show in Figure 11 (see page 94), however, the current value of the Proposition 13 bailout is approximately $6.1 billion. This estimate incorporates the current-year property tax shift and 14 years of growth in assessed value and health and welfare program costs. It does not, however, reflect other fiscal transactions between state and local government that have occurred since 1979-80—such as trial court funding changes and the transfer of financial responsibility to counties for medically indigent adults.

Figure 10

Local Government Impact of 1992-93 And Proposed 1993-94 Budget Cuts

(Dollars in Millions)

Type of Local Agency	Property Tax Shift	Total Revenues[a]	Percent Reduction
1992-93			
Counties[b]	$525	$25,036	2.5%
Cities	200	22,468	0.9
Special districts	375	14,504	2.6
Redevelopment agencies[c]	200	1,946	10.3
Totals	**$1,300**	**$63,954**	**2.0%**
1993-94 Proposed			
Counties, cities, and nonenterprise special districts (unallocated)	$2,075	$50,879	4.1%
Redevelopment agencies[d]	380	1,946	19.5
Enterprise special districts	150	11,129	1.3
Counties	70	—	—
Counties, cities, and nonenterprise special districts–unallocated tax gain[e]	-80	—	—
Totals	**$2,595**	**$63,954**	**4.1%**
Two-Year Totals	**$3,695**	**$63,954**	**5.8%**

[a] All revenue figures are 1990-91 data, except special districts (1989-90 fiscal year). Revenues include local taxes, state and federal aid, and user charges.
[b] City and County of San Francisco included in county totals.
[c] Redevelopment agencies funding reduction in 1992-93 was one-year only.
[d] Governor proposes to maintain the 1992-93 agency reduction ($200 million) and modify agency Statement of Indebtedness (SOI) calculations ($180 million). We estimate that modifications to the SOI will reduce agency funding by $300 million—or $120 million more than estimated by the Administration.
[e] Administration estimates that increases to city, county, and special district property tax revenues will be $80 million as a result of modifying agency SOI. We estimate that it will be $135 million.

The Administration's proposal, therefore, would take *more* than the estimated remaining value of the "AB 8" property tax shift, but *less than half* of the current value of the total Proposition 13 "bailout".

Our review also indicates that the budget proposal is inconsistent with its stated purpose of eliminating the bailout in two other ways:

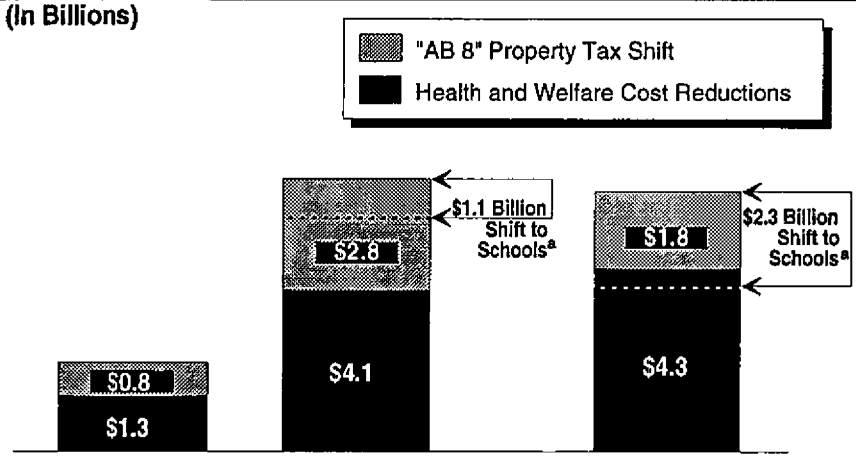
- It would take property taxes away from local agencies that did not benefit from the Proposition 13 fiscal relief package (such as redevelopment agencies).

- Local agencies that already lost all their Proposition 13 fiscal relief in the current year would face further property tax reductions.

Figure 11

Property Tax Shifts Reduce Value Of Proposition 13 Local Government "Bailout"

(In Billions)



[a] Excludes portions of property tax shifts relating to redevelopment agencies (which received no Proposition 13 bailout) and 1992-93 one-time related shifts.

Given the severity of the state's fiscal crisis, it is inevitable that some portion of the budget solution will be borne by local governments. Rather than considering this budget proposal in the context of a 14-year old fiscal relief program, however, we recommend that the Legislature consider this proposal in light of the relative need for state and local programs—and the appropriateness of the property tax to finance these needs.

Local Governments' Dependence Upon the Property Tax

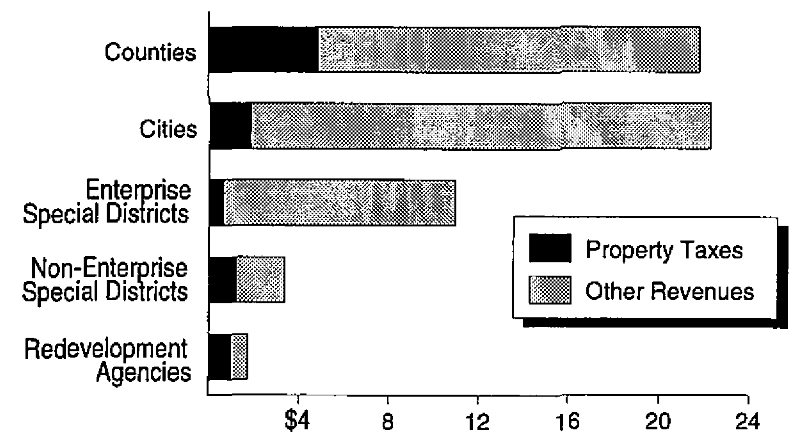
Local governments vary considerably in their dependence upon the property tax. This great variation will make the Legislature's task in allocating any property tax reduction much more complex.

Figure 12 shows the dependence on the property tax across local governments. Reliance upon the tax ranges from a high of about 61 percent for redevelopment agencies to less than 4 percent for enterprise special districts. There are also, however, very significant differences *within* groups of local government. Older cities, for example, tend to be much more dependent upon property tax revenues than newly incorporated cities (which receive relatively low allocations of property tax revenues). Similarly, counties without large retail establishments tend to depend more heavily upon property tax revenues than counties with auto malls and regional shopping centers in their unincorporated areas. Finally, fire protection, cemetery, flood, water conservation, and recreation and park districts depend on property taxes more than many other special districts.

Figure 12

Local Agency Dependence on Property Taxes
Property Taxes Relative to Other Revenues[a]

(In Billions)



[a] Excludes City and County of San Francisco. Data are for 1990-91 (1989-90 for special districts). Figures have been reduced to reflect the 1992-93 property tax shift.

Impact on Programs and Services

Almost all expenditures by special districts and cities are for traditional municipal programs, such as police and fire protection, and parks and recreation programs. Reducing one of the largest sources of general purpose revenues to these local agencies, therefore, inevitably will reduce the level of services provided under these programs.

The proposed property tax reduction for counties also would result in a decrease in funding for traditional municipal programs—although for somewhat different reasons. Unlike special districts and cities, counties provide a great variety of programs and services to California residents (from indigent health care to jails and elections). As we discussed above, however, about 88 percent of county expenditures are required by state or federal law, leaving counties direct control over the expenditure of only about $3.1 billion. These county discretionary funds are spent for public protection and other traditional municipal service programs. Unless the Legislature acts to give counties greater discretion over their budgets or access to other sources of funding, property tax losses will necessarily reduce county municipal service programs.

Finally, California's redevelopment agencies (RDAs) also would experience severe program reductions under the budget proposal. This is because the budget proposal (1) maintains the current-year requirement that RDAs transfer to schools an amount equal to 16 percent of agency property tax revenues and (2) further limits agency property tax revenues to the dollar amount needed to pay that year's debt service. Aside from the difficulties this may pose for existing RDA programs, it also raises the concern that RDAs will (1) cease all new urban revitalization and low-income housing construction activities and (2) shift costs to administer existing programs and repay debt service to cities and counties, requiring further cutbacks by these agencies.

Impact on New Development

Virtually all new developments—residential, commercial, and industrial— impose increased costs to local governments. New housing subdivisions, for example, enlarge the population needing public services. New manufacturing centers increase traffic and demand for water and solid waste disposal services.

Currently, many of these increased public costs are fully offset through the payment of property taxes by owners of new developments. By transferring a substantial amount of local government property tax revenues to K-14 districts as proposed, however, property tax revenues from new developments will offset *much less* of their public cost to local governments. As a result, local governments will have less incentive to rezone land or make other changes required in the process of approving new development projects.

Ability to Raise Revenues to Replace Loss of Property Taxes

While local governments have authority to levy assessments, charge fees, and impose a variety of taxes, our review indicates that these revenue sources will not be sufficient to offset the proposed property tax losses.

Dubious Assumptions Included in Proposal

The Legislature's task in evaluating the proposed property tax transfer is further complicated by two unlikely assumptions included in the proposal. Specifically, the budget assumes that:

- Special districts will transfer $375 million in property taxes to schools again in the budget year, even though only a portion of these monies will be transferred in the current year, and court cases questioning the constitutionality of this transfer are pending.
- School districts in counties throughout the state can use the full amount of additional property tax revenues to replace state aid. Our analysis indicates that, in some counties, the amount of revenue proposed to be shifted could *exceed* the amount of state General Fund monies that could be freed up by the shift.

Finally, the budget includes very rough estimates of the amount of property tax revenues to be transferred by (1) modifying the Statement of Indebtedness (SOI) calculations by redevelopment agencies and (2) eliminating most property taxes to enterprise special districts. In the case of the SOI modifications, we estimate that the budget *understates* the amount of property tax to be transferred by $120 million. In the case of the enterprise special districts, we estimate that the budgeted amount could be in error in either direction by a range of tens of millions of dollars.

This report was prepared by Marianne O'Malley and Peter Schaafsma, with the assistance of many others in the office. For information concerning this analysis, please contact the author at (916) 445-6442.

Most local governments, for example, have authority to levy benefit assessments and institute user charges. These revenue sources only can be used, however, to recapture the cost of providing a specific benefit to a group of property owners or service users. Thus, special districts may collect assessments or fees to cover the cost of providing flood protection, lighting services, or recreational programs, but counties may not use assessments or fees to pay for general governmental programs, such as elections, or for their required share of AFDC costs.

Cities and counties also have authority to institute a variety of taxes, including utility users', business license, property transfer, and transient occupancy taxes. These taxes raised a total of $2.4 billion in general purpose revenue for California's cities and counties in 1990-91. While cities and counties could increase the total revenues from these sources somewhat by raising the tax rates, many of the tax rates are at (or near) their practical or legal limit.

Finally, California counties have authority to impose a half-cent increase on the sales tax. While imposing such a tax could raise up to $1.5 billion for county programs in the budget year, our review indicates that counties cannot depend on this revenue source to replace their property tax losses for a variety of reasons. First, California voters have been reluctant to approve such measures by the requisite margins. (Tax increases for general governmental purposes require a majority vote; tax increases to fund specific programs require a two-thirds vote.) Second, imposition of the tax would require at least 120 days (to organize an election and to wait the statutorily required 90 days after the election before collecting the tax). Thus, even if a sales tax measure were to pass, it is unlikely that a county would receive substantial revenues from this source in the budget year. Third, some rural counties have few retail establishments. Increasing the sales taxes in these counties would not fully replace property tax revenue losses.

Fiscal Condition of Local Government

Like state government, the fiscal condition of many local governments in California has become strained and has resulted in significant program reductions. Given the continuing recession and increased demand for public services, many local governments would continue to experience significant fiscal difficulties—even without the proposed loss in property tax dollars.

Legislative Analyst's Office

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State Spending Plan for 1991-92: The 1991 Budget Act and Related Legislation (September 1991), Report No. 91-5.

Options for Addressing the State's Fiscal Problem (January 1992), Report No. 92-1.

Supplemental Report of the 1992 Budget Act, 1992-93 Fiscal Year (Containing statements of intent or requests for studies adopted by the Legislature) (October 1992).

State Spending Plan for 1992-93 (November 1992), Report No. 92-3.

Analysis of the 1993-94 Budget Bill (February 1993). This report presents the results of our detailed examination of the Governor's Budget for 1993-94.

The 1993-94 Budget: Perspectives & Issues (February 1993). This report provides perspectives on the state's fiscal condition and the budget proposed by the Governor for 1993-94, and identifies some of the major issues facing the Legislature.

Analysis of the 1993-94 Budget Bill—Summary of Findings and Recommendations (February 1993), Report No. 93-1.

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