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September 22, 2010

Proposition 22

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Transportation and Housing Committee

Hon. Alan Lowenthal, Chair

Senate Local Government Committee

Hon. Christine Kehoe, Vice-Chair

Background

☑ **California State and Local Government Are Highly Interrelated.**

- Both levels of government share revenues raised by some taxes—such as sales taxes and fuel taxes.
- Both levels of government share the costs for some programs—such as many health and social services programs.

☑ **Over the Years, the State Has Made Decisions That Have Affected Local Government Revenues and Costs.**

☑ **Recent Measures Limit State Authority Over Local Government.**

- Proposition 1A (of 2004 and 2006) amended the California Constitution to limit state authority over local finance and program costs.
- Proposition 22 would broaden these constitutional limitations.

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Proposition 22 Overview

☑ **Proposition 22 Reduces or Eliminates the State's Authority to:**

- Redirect redevelopment property tax revenues to other local governments.
- Shift property taxes from cities, counties, and special districts to schools.
- Use vehicle license fee (VLF) revenues to reimburse local governments for state mandated costs.
- Use state fuel tax revenues to pay debt service on state transportation bonds.
- Borrow or change the distribution of state fuel tax revenues.

☑ **Fiscal Effect: No Change to Overall State-Local Government Costs or Revenues.**

- Due to restrictions on state authority over fuel and property taxes, the state would have to take alternative actions—probably in the range of $1 billion to several billion dollars annually.
- This would result in (1) reduced state General Fund program spending and/or increases in state revenues of those amounts and (2) comparable increases in transportation and redevelopment revenues.

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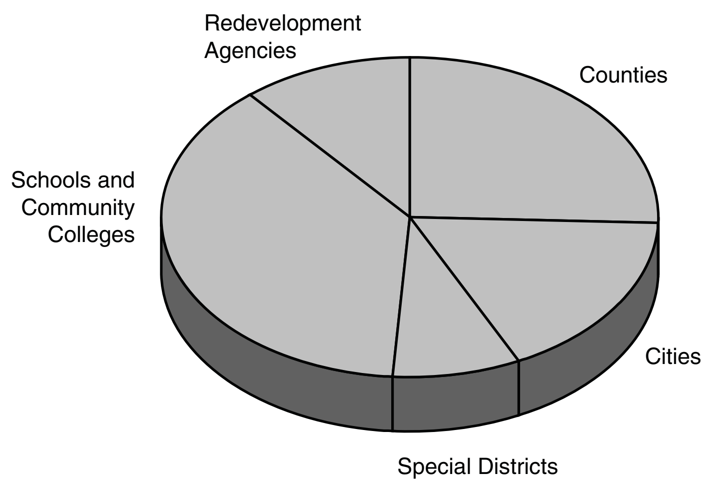
Authority Over Property Tax Distribution

Estimated Local Government Shares of the 1 Percent Property Tax

Statewide Average



Excludes effect of any temporary property tax shifts.

☑ **Under Proposition 13, State Laws Direct County Auditors How to Allocate Property Tax Revenues.** Proposition 1A (2004) imposed some restrictions on this state authority.

- No more than twice in a decade, the Legislature may temporarily increase the share of property tax revenues allocated to schools and community colleges (a "Proposition 1A loan"). The state must repay affected cities, counties, and special districts with interest, within three years.
- Laws that change the allocation of property taxes among cities, counties, and special districts must be approved by a two-thirds vote of both houses.

Authority Over Property Tax Distribution

(Continued)

☑ **Local Redevelopment Decisions Also Affect Property Tax Distribution.** If a redevelopment agency creates a project area, the agency:

- Receives all growth in property tax revenues from the project area.
- Shares a portion of these property tax revenues with affected local agencies ("pass-through payments").

Proposition 22 Provisions: Property Tax, Redevelopment, and VLF

☑ **Eliminates State's Authority to Temporarily Increase School And Community Colleges' Share of Property Tax Revenues.**

- Existing $1.9 billion Proposition 1A property tax loan would be repaid as planned.
- No future Proposition 1A loans would be permitted.

☑ **Prohibits State From Borrowing or Redirecting Redevelopment Property Tax Revenues—or Requiring Increased Pass-Through Payments.**

- Appears to eliminate state authority to enact new laws similar to the 2009 measure requiring redevelopment agencies to give $2 billion to school districts.

☑ **Prohibits State From Reallocating VLF Revenues to Pay for State-Imposed Mandates.**

- No immediate effect, but could restrict state fiscal flexibility with regards to future realignments of state-local programs.

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Fiscal Effect: Property Tax, Redevelopment, And VLF Provisions

☑ **No Change to Overall State-Local Government Costs or Revenues.**

☑ **Higher Redevelopment Revenues.**

- Due to restrictions on state authority over redevelopment property tax revenues and pass-through payments, the state would have to take alternative actions to address its fiscal and policy objectives.
- This could result in reduced state General Fund program spending or increased state revenues.

☑ **Other Fiscal Effects.**

- Potential small increase in local government property tax revenue stability.
- Potential increased state costs to implement future state-local program realignments.

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Proposition 22 Provisions: Use of Funds to Pay for Transportation Bonds

☑ Under current law, the state uses some of its fuel tax revenues to pay debt-service costs on voter-approved transportation bonds.

- In 2010-11, about $850 million in transportation debt-service costs will be paid from fuel tax revenues.
- In future years, this amount is expected to increase to about $1 billion annually.

☑ Proposition 22 would restrict the states authority to pay transportation debt-service costs with fuel tax revenues. Because of these restrictions, the state would instead need to pay these costs from the General Fund.

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Proposition 22 Provisions: Prohibits Borrowing of Fuel Tax Revenues

- ☑ Under current law, while state fuel tax revenues generally must be used for transportation purposes, the state may borrow the funds for other purposes.
  - ***Borrowing for Cash Flow.*** To help manage uneven cash flow, the state often borrows from various state accounts, including fuel tax funds, on a temporary basis. The cash flow loans of fuel tax funds often total $1 billion or more.
  - ***Borrowing for Budgetary Purposes.*** In cases of severe fiscal hardship, the state may use fuel tax revenues to help address a budgetary problem. The state must repay these funds within three years. In 2010-11, the state plans to borrow $650 million in fuel tax revenues to help address the General Fund budget problem.
- ☑ Proposition 22 prohibits fuel tax revenues from being loaned—either for cash flow or budget-balancing purposes—to the General Fund or any other state fund.

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Proposition 22 Provisions: Limits Authority to Change Distribution of Fuel Tax Revenues

- ☑ Current law provides 6 cents out of the first 18 cents of fuel excise tax revenues to be given to cities and counties. While this sharing of revenues has been in place for many years, the Legislature does have the authority to change the allocation with a majority vote.

- ☑ Proposition 22 would require a two-thirds vote of each house of the Legislature and a public hearing process to be conducted in order to change the amount of fuel excise tax revenues shared with cities and counties.

- ☑ In the case of diesel sales tax revenues, current law requires that funds be distributed 25 percent to the state, and 75 percent to local governments. The Legislature has the authority to change the allocation of these revenues with a majority vote, and has done so in recent years.

- ☑ Proposition 22 would require that funds be split equally between the state and local governments. By making this distribution of funds a constitutional requirement, the measure would also prohibit the Legislature from changing the allocation.

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Fiscal Effect: Transportation

- ☑ ***State General Fund Effect in 2010-11.*** Proposition 22 would (1) shift some debt-service costs to the state General Fund and (2) prohibit the General Fund from borrowing fuel tax revenues. As a result, the measure would reduce resources available for other programs, probably by about $1 billion in 2010-11.

- ☑ ***State General Fund Longer Term Effect.*** Limiting the state's authority to use fuel tax revenues to pay transportation bond costs would increase General Fund costs by about $1 billion annually for the next couple of decades.

- ☑ ***Transportation Programs Effect.*** Under the measure, the state would use General Fund revenues—instead of fuel tax revenues—to pay for transportation bonds. This would leave more fuel tax revenues (about $1 billion annually) available for transportation programs.