

A Voyage Into the Strange World of California City Finance

Michael Coleman
coleman@cal.net
tel/FAX: 530.758.3952



For more info visit the California Local Government Finance Almanac
at californiacityfinance.com

Cities . . .



- ◆ are general purpose local governments
- ◆ provide essential frontline municipal services tailored to meet the unique needs of the communities they serve



- ◆ are funded mostly by locally enacted revenues



- ◆ provide land use planning and control



2 ColemanAdvisoryServices ©2002

June 2002



Types of Funds Where the money comes from determines how it can be spent

- ◆ **General Fund** is used to account for money which is not required legally or by sound financial management to be accounted for in another fund.
- ◆ **Enterprise Funds** are used to account for self supporting activities which provide services on a user-charge basis. Examples: water, garbage, parking, golf, marina.
- ◆ **Special Revenue Funds** are used to account for activities paid for by taxes or other designated revenue sources which have specific limitations on use according to law. Example: gas tax.
- ◆ **Internal Service Funds** are used to account for services provided internally in support of various City departments by a department or function. Revenues for these funds are received from the departments to whom services are provided. Examples: self insurance fund, vehicle maintenance fund.



3 ColemanAdvisoryServices ©2002

June 2002

Taxes

- ◆ A charge which pays for public services and facilities that provide general benefits. There need not be a direct relation between an individual taxpayer's relative benefit and the tax paid.
- ◆ Cities may impose any tax not otherwise prohibited by state law. (Gov Code § 37100.5)
- ◆ The state has reserved a number of taxes for its own purposes including cigarette taxes, alcohol taxes, personal income taxes.



4 ColemanAdvisoryServices ©2002

June 2002

Taxes: General and Special

- ◆ **General Taxes** - revenues may be used for any purpose.
 - Majority voter approval required for new or increase
- ◆ **Special Taxes** - revenues must be used for a specific purpose.
 - 2/3 voter approval required for new or increase
 - Parcel tax - requires 2/3 vote



5 ColemanAdvisoryServices ©2002

June 2002

Property Tax

- ◆ An *ad valorem* tax imposed on real property and tangible personal property
- ◆ Maximum 1% rate (Article XIII A) of assessed value, plus voter approved rates to fund debt
- ◆ Assessed value capped at 1975-76 base year plus CPI or 2%/year
- ◆ Property that declines in value is reassessed to the lower market value.
- ◆ Reassessed to current full value upon change in ownership (with certain exemptions)
- ◆ Allocation: shared among cities, counties and school districts per AB8 (1980)

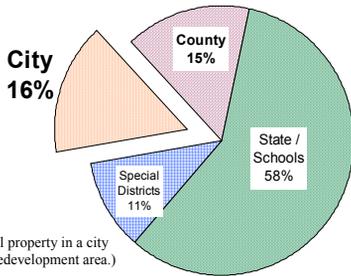


6 ColemanAdvisoryServices ©2002

June 2002

Where Your Property Tax Goes . . .

Typical city resident



(Typical property in a city not in redevelopment area.)

SOURCE: Calif State Board of Equalization, Coleman Advisory Services

7 ColemanAdvisoryServices ©2002

June 2002



Property Tax Exemptions include . . .

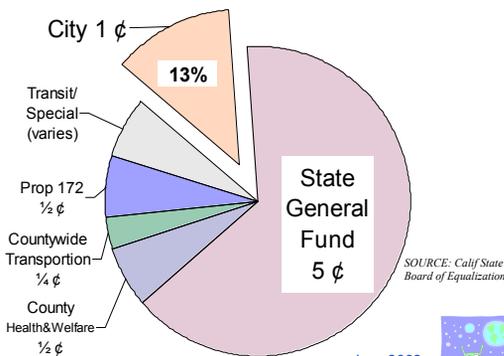
- ◆ government owned, nonprofit educational, religious, hospital, charitable, cemetery
- ◆ first \$7,000 of an owner occupied home;
- ◆ business inventories; household furnishings & personal effects; timber;
- ◆ motor vehicles, freight & passenger vessels;
- ◆ crops & orchards (first 4 years)

8 ColemanAdvisoryServices ©2002

June 2002



Where Your Sales Tax Goes . . .



SOURCE: Calif State Board of Equalization

9 ColemanAdvisoryServices ©2002

June 2002



Sales and Use Tax

- ◆ **Sales Tax:** imposed on the total retail price of any tangible personal property
- ◆ **Use Tax:** imposed on the purchaser for transactions in which the sales tax is not collected.

10 ColemanAdvisoryServices ©2002

June 2002



Sales and Use Tax

- ◆ BradleyBurns Uniform Local Sales&Use Tax(1955)
 - 1.0% allocated on "situs" - general purpose
 - 0.25% to countywide transportation
- ◆ Proposition 172 (1993) - 0.5% limited to "public safety" use
 - Allocation formula related to ERAF property tax shift. 94% to counties (\$2.2B), 6% to cities (\$135M)
- ◆ Special Transaction & Use Taxes - usually transportation - varies by county, some cities

11 ColemanAdvisoryServices ©2002

June 2002



Sales and Use Tax Exemptions . . .

- ◆ Resale, interstate sales, intangibles,
- ◆ Food for home consumption, candy, bottled water,
- ◆ Natural gas, electricity & water delivered through pipes,
- ◆ Prescription medicines,
- ◆ Agricultural feeds, seeds, fertilizers,
- ◆ Sales to the federal government,
- ◆ others

12 ColemanAdvisoryServices ©2002

June 2002



Other Locally Adopted Taxes

- ◆ Business License Tax
- ◆ Utility User's Tax
- ◆ Transient Occupancy (Bed) Tax
- ◆ Real Property Transfer Tax (Documentary Transfer Tax)
- ◆ Admissions Tax
- ◆ Parking Tax

13 ColemanAdvisoryServices ©2002

June 2002



Fees & Charges

- ◆ A voluntary charge imposed on an individual for a service or facility provided directly to that individual. A fee may not exceed the estimated reasonable cost of providing the particular service or facility for which the fee is charged, plus overhead.
- ◆ Cities have the general authority to impose fees (i.e., charges, rates) under the city's police powers*
- ◆ Specific procedures in state law for fee & rate adoption.
- ◆ "Property related" fees - special rules under Prop 218.
- ◆ Examples: water service, sewer service connection, building permit, recreation class, development impact fees.

*as defined by Article XI, Sec. 7 and Article XIII B, Sec. 8 of the California Constitution.

14 ColemanAdvisoryServices ©2002

June 2002



Assessments

- ◆ Charges levied to pay for public improvements or services within a pre-determined district or area according to the benefit the parcel receives from the improvement or services.
- ◆ Rules and procedures under Proposition 218.

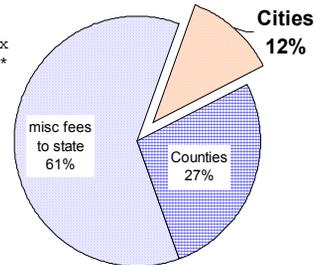
15 ColemanAdvisoryServices ©2002

June 2002



Where Your Vehicle License and Registration Fees Go . . .

Cities	12%	Car Tax	
Counties	27%	(VLF)*	
Calif Hwy Patrol	18%		
State DMV	13%		
State Highways	15%		
State Agencies	3%		
State General Fund	12%		
Total DMV Fees		100%	



*After 67.5% VLF cut effective January 2001

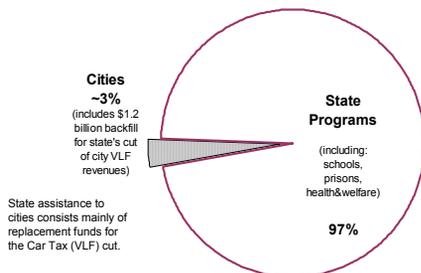
SOURCE: Calif State Controller, DMV, Coleman Advisory Services

16 ColemanAdvisoryServices ©2002

June 2002



State General Revenues including State Income Tax, State Sales&Use Tax: How much goes to your city?



SOURCE: Governor's Budget Summary, Coleman Advisory Services

17

June 2002



Intergovernmental Subventions

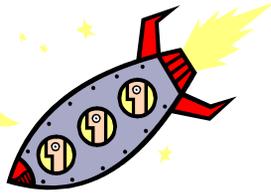
- ◆ State Grants
 - Motor Vehicle In-Lieu Tax (VLF) . \$1.7 Billion
 - Homeowners Property Tax Relief \$ 54 Million
 - Gas Tax . . . \$585 Million
 - Streets/Roads (state sales tax on gas) . . . \$100 Million
 - COPs / SLESP . . . \$78 Million
 - Police Tech / CLEEP . . . \$28 Million
 - Mandate Reimbursement . . . \$351 Million
 - Other . . . ~ \$150 Million
- ◆ County Grants . . . \$150 Million
- ◆ Federal Grants . . . \$1.5 Billion

18 ColemanAdvisoryServices ©2002

June 2002

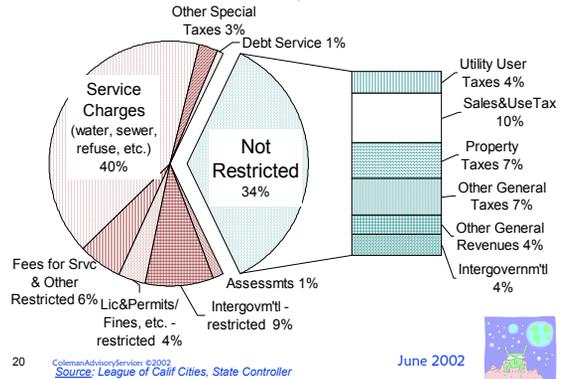


To Infinity
and Beyond

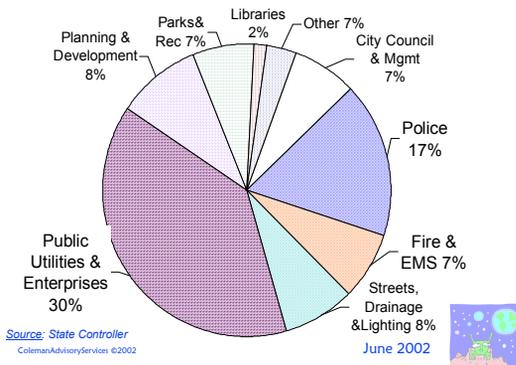


City Budget Basics

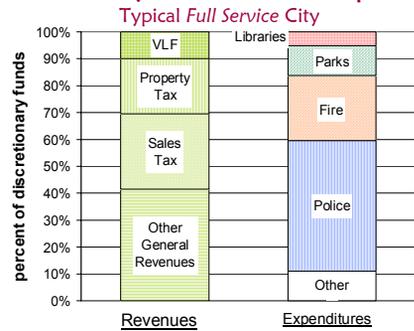
California City Revenues



California City Spending

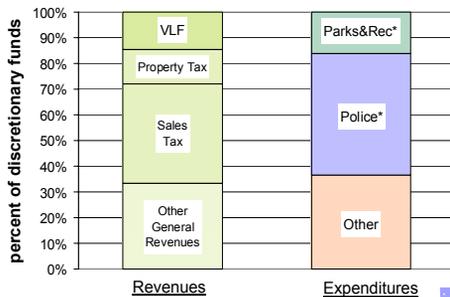


Discretionary Revenues and Spending



Discretionary Revenues and Spending

Typical Low Property Tax (non-full service) City



*Fewer than 25% of these cities are financially responsible for library services. Fewer than 35% are responsible for fire services.

23 ColemanAdvisoryServices ©2002 June 2002

The Value of City Services

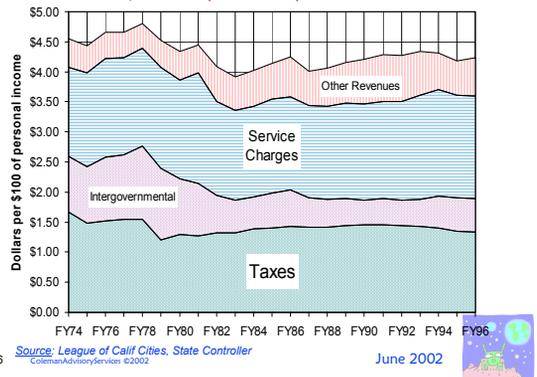
- ◆ The average city resident pays \$50.29/month for city services (not including fee-funded public utilities such as water, sewer, flood control and garbage collection provided by many cities)
 - ◆ \$50.29 pays for one of these:
 - One month of cable service
 - One or two hardback books
 - One month at the gym
 - Three compact disks
 - Dinner for two
 - Movie and snacks for a family of four
 - ◆ Or... \$50.29 pays for all of these:
 - 24 hour police and fire protection
 - Well-groomed parks and trees
 - Safety lighting for streets
 - Community events
 - Community economic development
 - Paved and maintained city streets
 - Community library system
 - A well-planned, zoned community
 - Professional management of a citizen's tax investment in the community
- 24 ColemanAdvisoryServices ©2002 June 2002

Surveying the Lunar Landscape



Trends and Issues in Municipal Finance

The Burden of City Gov't Has Declined city revenues per \$100 of personal income



Trends in Calif City Finance

- ◆ Decline of property tax \$
 - Prop 13 slashed #1 source of local \$ and gave authority to allocate to state legislature.
 - ERAF \$3.7billion/year (including ~\$550million / year from cities)
 - Since 1992-93 cities have lost \$3.2 Billion in property taxes (net of Prop 172)
 - 15% of total city \$ in 1976
 - 7% of total city \$ in 1996
- ◆ Decline of state and federal aide to cities
 - State & federal \$ to Calif cities down from 21% in 1974-75 to 13% today

Leading Sources of California City Revenues

	FY 1974-75 (pre Prop 13)	FY 1978-79 (after Prop 13)	FY 1998-99 (Recent)
1. ServiceCharges	35.2%	36.9%	41.2% ↑
2. Intergovernm'l	21.2%	26.5%	13.3% ↓
3. Property Tax	14.8%	5.8%	6.7% ↓
4. Sales&UseTax	11.4%	11.9%	10.1%
5. Use \$/Property	3.7%	3.5%	4.7% ↑
6. Other	13.7%	15.5%	20.0% ↑
7. Other			4.0% ↑

Source: State Controller

27 ColemanAdvisoryServices ©2002

June 2002



28 ColemanAdvisoryServices ©2002

June 2002



Local Subventions Repealed by the State

1. Business Inventory Exemption (1979 \$42m/yr)
2. Liquor License Fees (1981 \$28m/yr)
3. Highway Carriers Uniform Business License Tax (1981 \$7m/yr)
4. Bank-in-Lieu [FALA] (1981 \$109m/yr)
5. Cigarette Tax (1991 \$40m/yr)

29 ColemanAdvisoryServices ©2002

June 2002



Trends in Calif City Finance

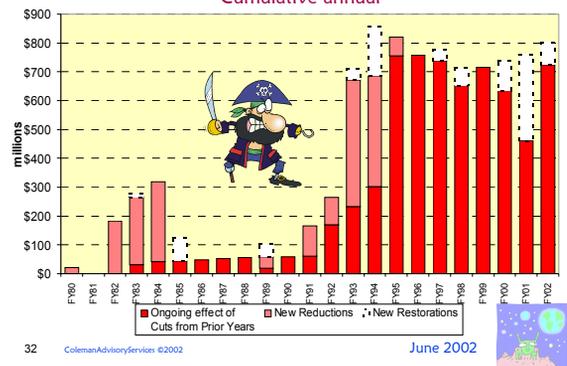
- ◆ Decline of sales tax base
 - Shift to service oriented economy
 - Increasing internet and catalog retail
- ◆ State intrusion into local policy, unfunded mandates
- ◆ Limitations on taxes, fees, etc.
 - Prop 13, Prop 62, Prop 218, AB1600.

31 ColemanAdvisoryServices ©2002

June 2002



State Cuts of City Revenues



Trends in Calif City Finance

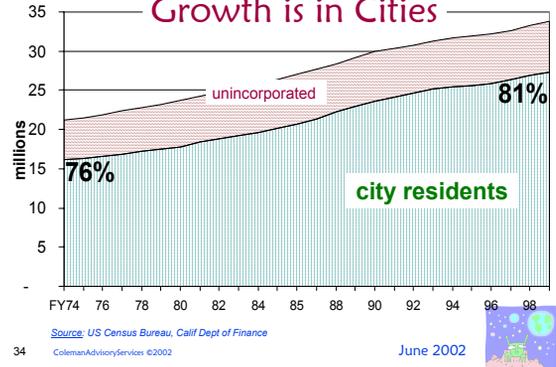
- ◆ Population growth is in cities
- ◆ Greater array & cost of services, new challenges.
 - high tech, cable, transit, etc.
- ◆ Public safety spending gobbling up more \$
- ◆ Infrastructure cracking under neglect.

33 ColemanAdvisoryServices ©2002

June 2002

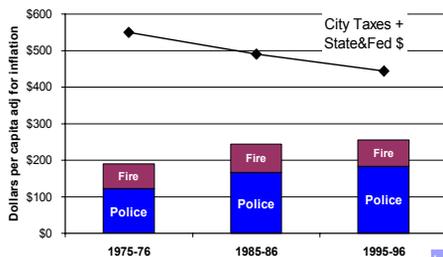


California's Population Growth is in Cities

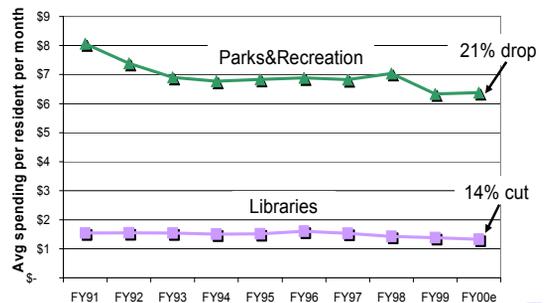


The Squeeze:

- Increasing Police & Fire Spending
- Declining Taxes & State/Federal Transfers



Taking the Hits: Parks and Libraries



a few words about . . .

Counties

- ◆ Hybrid Local/state
 - administer state programs
 - social services, etc.
 - provide countywide local services
 - jails, courts, etc.
 - provide “city” services to unincorporated areas
- ◆ More mandates, less discretionary \$, more vulnerable to state budgetary action

37 ColemanAdvisoryServices ©2002

June 2002



and a few words about . . .

Special Districts

- ◆ some “dependent” - some “independent”
- ◆ some are enterprise (water, irrigation, sanitation) - some are not (parks & rec, mosquito abatement, fire)
- ◆ where they provide services instead of city or county, they may get a cut of the property tax
- ◆ **redevelopment agencies** are dependent special districts

38 ColemanAdvisoryServices ©2002

June 2002



Community Redevelopment Agencies

- ◆ (Property) tax increment financing
- ◆ Most important urban renewal tool for cities (and some counties)
 - Purpose:
 - guide patterns of
 - urban community development
 - economic development
 - remove blight - improve quality of life for the total community
 - enhance value and return
 - Flexible tool – can be used well and . . . Not

39 ColemanAdvisoryServices ©2002

June 2002



The Problems With California State and Local Government Finance are:

1. Decline of predictable, discretionary funding for key city services
 - Revenue instability & constraints hamper good governance
2. Fragmentation of local finance and governance among overlapping governments
3. Disconnect between service costs and revenues in urban development imperils city services and deters balanced planning.

40 ColemanAdvisoryServices ©2002

June 2002



Revenue Instability & Constraints Hamper Good Governance

- ◆ Unable to predict revenue availability, city councils may defer infrastructure maintenance / development, community planning, regional cooperation, and investments that will produce long-term returns.
- ◆ This fiscal dependence on state government decisions discourages innovative solutions to long-term community problems.
- ◆ Few political gains for legislators who try to help make local governments more financially stable over the long haul. Tendency to fund categorical programs.

41 ColemanAdvisoryServices ©2002

June 2002



Other Issues

in Local Gov't Finance Reform

- ◆ State Mandates
 - ◆ Program mandates
 - ◆ Process mandates
 - ◆ Revenue use restrictions
- ◆ Calif taxpayers' federal income tax liability could be reduced by greater shift to deductible state and local taxes.
- ◆ Proposition 13 reassessment rules discourage new business.
- ◆ Sales Tax growth in decline with shift to service economy, e-commerce.
- ◆ Super-majority vote requirements.

42 ColemanAdvisoryServices ©2002

June 2002



UFOs Arrive

a primer on . . .



- Proposition 13
- E R A F
- Proposition 218

43 ColemanAdvisoryServices ©2002

June 2002



Proposition 13 - nuts & bolts

1. Limits property tax rate to 1% of full market value,
2. Caps the increase in property value at 2% with reassessment at full market value only upon change of ownership,
3. Rolls back property values for tax purposes to 1975-76 levels,

44 ColemanAdvisoryServices ©2002

June 2002



Proposition 13 - nuts & bolts

4. Requires 2/3 voter approval to raise “special taxes,”
5. Requires any bill to increase state revenues to be approved by 2/3 vote of each house of the state legislature,
6. Transferred the authority for allocating property tax revenues from local government to the state.

45 ColemanAdvisoryServices ©2002

June 2002



Proposition 13 - effects

- ◆ Elderly and Low Income Homeowners’ tax burden lowered
- ◆ Disparate treatment of similarly situated properties
- ◆ Local government property tax revenues cut by 60%
- ◆ Revenue windfalls: State \$1 billion, Federal \$1.6 billion

46 ColemanAdvisoryServices ©2002

June 2002



Proposition 13 - effects

- ◆ Local government property tax revenues now depend on:
 - pre-prop 13 tax rate relative to others
 - assessed valuation
 - differences in service responsibility
 - redevelopment
- ◆ Tax rates / shares out of sync with service demands

47 ColemanAdvisoryServices ©2002

June 2002



Proposition 13 - effects

- ◆ Greater reliance on state general fund for county and school funding (especially)
 - commensurate shift of power
- ◆ Cities and counties raised user fees and local taxes
 - variety/complexity of municipal revenue
- ◆ State authority to allocate local property tax
- ◆ “Fiscalization of land use”

48 ColemanAdvisoryServices ©2002

June 2002

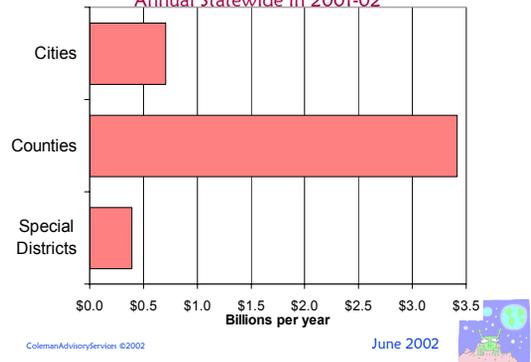


ERAF - The Property Tax Shifts

- ◆ \$3.6 billion shift of city, county and special district revenue to the state general fund
 - by shifting to local schools thereby relieving state general fund obligation for school \$
- ◆ City property tax shares reduced by 24% (on average)
- ◆ State action enabled by a provision of Proposition 13

Loss to E.R.A.F.

Annual Statewide in 2001-02



49 ColemanAdvisoryServices ©2002

June 2002



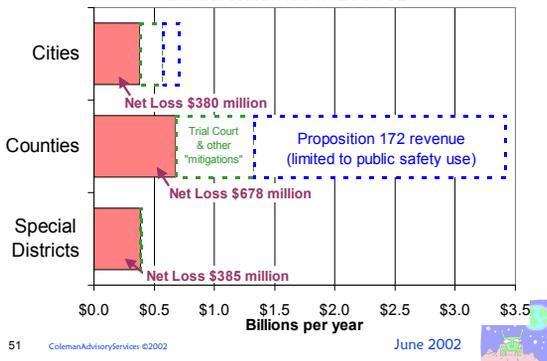
50 ColemanAdvisoryServices ©2002

June 2002



Net Loss: E.R.A.F. & "Mitigations"

annual statewide in 2001-02



51 ColemanAdvisoryServices ©2002

June 2002



52 ColemanAdvisoryServices ©2002

June 2002



Proposition 218 The Right to Vote on Taxes (and more)

- ◆ **General Tax** increase > majority voter approval
- ◆ **Property Assessment** > vote by mail (weighted by assessment \$ amount)
- ◆ **Property-Related Fees** > majority vote of the fee payers or 2/3 vote of electorate. (except sewer, water & refuse collection)

Proposition 218 General Taxes and Property Assessments

- ◆ **General Tax** increase requires majority voter approval
 - Constitutional requirement > charter cities
- ◆ **Property Assessments**
 - Limited to "special benefits"
 - Vote by mail approval (weighted by assessment \$ amount)
 - Government agencies assessed

53 ColemanAdvisoryServices ©2002

June 2002



Proposition 218 Property-Related Fees

- ◆ New noticing procedures - Majority protest nixes it
- ◆ Approval by majority vote of the fee payers or 2/3 vote of the electorate.
 - Exceptions: sewer, water & refuse collection
- ◆ Fees may not exceed the cost of service
 - may not be used for other purposes
 - may not exceed the proportional cost of service to the parcel
 - must be actually used by or immediately available to the fee payer - "stand-by charges" and "future facilities fees" must be adopted as assessments

54 ColemanAdvisoryServices ©2002

June 2002

