A Voyage Into the Strange World of California Municipal Finance

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

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Cities Vary and so do their finances

- Geography: proximity, climate, terrain, access
- Community Character / Vision: Land use
- Size – urban / rural
- Governance – full service / not

- Statewide generalizations often mask trends among sub-groups
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.
- **Other Funds**: Internal Service Funds, Trust Funds, Reserve Funds

The Mechanics of Government Revenue

- Who pays?  
- What on?  
- What rate?  
- Who gets the revenue?  

- Who collects? Who enforces payment?  
- Who Decides?  
  - Statewide voters  
  - State law / Legislature  
  - Local voters  
  - Local law / City Council  

Where the money comes from determines how it can be spent
## Blast-Off: Taxes, Fees, Charges, Assessments

### 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.

### 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
Property Tax

- An *ad valorem* tax imposed on real property and tangible personal property
- Maximum 1% rate (Article XIIIA) 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)

Where Your Property Tax Goes

- Typical city resident
  - City: 21%
  - County: 27%
  - Local Schools: 45%
  - Special Districts: 7%

Source: Coleman Advisory Services computations from Board of Equalization and State Controller data.
Includes Property Tax in-lieu of VLF.

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.

Sales and Use Tax Local portions ...

- Bradley Burns 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 ($2.3B), 6% to cities ($150M)
- Special Transaction & Use Taxes - usually transportation - varies by county, some cities
Where Your Sales Tax Goes

City 1¢
Transit/Special (varies)
Prop 172 ½¢
Countywide Transportation ¼¢
County Health & Welfare ½¢

State General Fund 5¢

13%

Other Locally
Adopted Taxes

✔ Business License Tax
✔ Utility User’s Tax
✔ Transient Occupancy (Bed) Tax
✔ Documentary Transfer Tax / Real Property Transfer Tax
✔ Admissions Tax
✔ Parking Tax

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.

Assessments

- Charges levied to pay for public improvements or services within a predetermined district or area according to the benefit the parcel receives from the improvement or services.
- Rules and procedures under Proposition 218.
Other Locally Raised Revenues

✔ Licenses and Permits
✔ Franchises
✔ Rents, Royalties & Concessions
✔ Fines, Forfeitures & Penalties
✔ Investment Earnings

Intergovernmental Subventions

Money granted to support or aid some cause, institution or undertaking

□ One time or on-going?
□ Earmarked or general purpose?
□ In lieu of local tax?

Intergovernmental Subventions to cities ...

✔ Motor Vehicle In-Lieu Tax (VLF) $200 Million
   ▪ A state-imposed tax distributed to cities and counties in-lieu of property taxation of automobiles

✔ State Grants
   ▪ Homeowners Property Tax Relief ... $ 50 Million
   ▪ Gas Tax ... $600 Million
   ▪ Sales Tax on Gasoline (Prop42) ... $127 Million
   ▪ Other ... $600 Million

✔ County Grants ... $150 Million
✔ Federal Grants ... $1.5 Billion
Surveying the Lunar Landscape

Trends and Issues in Municipal Finance

Leading Sources of California City Revenues

<table>
<thead>
<tr>
<th>FY 1974-75 (pre Prop 13)</th>
<th>FY 1980-81 (after Prop 13)</th>
<th>FY 2001-02 (recent)</th>
<th>FY 2004-05 (VLF-PropTaxSwap)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. SrvcCharges 35%</td>
<td>1. SrvcCharges 37%</td>
<td>1. SrvcCharges 40%</td>
<td>1. SrvcCharges 40%</td>
</tr>
<tr>
<td>5. Rents,etc. 4%</td>
<td>5. Rents,etc. 4%</td>
<td>5. Rents,etc. 5%</td>
<td>5. Rents,etc. 5%</td>
</tr>
<tr>
<td>7. Other 10%</td>
<td>7. Other 15%</td>
<td>7. UtilityUserTax 4%</td>
<td>7. Veh.Lic.Fee 1%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>8. Other 18%</td>
<td>8. Other 19%</td>
</tr>
</tbody>
</table>

Source: Computations by Coleman Advisory Services from Calif. State Controller reports.

The Changing Character of California City Revenues

California City Revenue Per Capita Adjusted for Inflation

Discretionary Revenues and Spending

Typical Full Service City

Revenues

Expenditures

CaliforniaCityFinance.com

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State Cuts of City Revenues

Cumulative annual

Cumulative annual

Source: CaliforniaCityFinance.com

Cities are Net Donors to the State General Fund

Proposition 1A (Nov 2004)

Constitutionally prohibits the state from:

- Reducing the local sales tax rate or altering its method of allocation.
  - Exception: interstate compact, e.g., for streamlined sales tax/remote sales.
- Decreasing VLF revenue from the 0.65% rate without providing replacement funding to cities and counties.
- Shifting property taxes from cities, counties, or special districts.
  - Legislature may reallocate among cities, counties, and special districts with a 2/3 vote of both houses of the legislature.
  - Beginning FY08-09, may borrow up to 8% of local prop tax revenues (currently about $1.3Bil) under certain conditions.
- Strengthens prohibitions against unfunded state mandates

Source: CaliforniaCityFinance.com
**Tyranny of a Minority:**
Special Taxes (2/3 Vote) Difficult to Pass

Countywide Transportation Sales Tax Measures over the Last Ten Years

- **Pass with 2/3 Vote:** 7 measures
  - Measures to continue an existing tax: 2 measures passed
  - New tax measures: 5 measures passed with <55% yes
  - Failed with more than 55% Yes: 6 measures

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**Taxable Sales’ Have Dropped as Share of Personal Income**

- Revenue from a 1 Percent Sales Tax Rate as a Percentage of Personal Income
  - 1960-61: 0.40%
  - 1964-65: 0.30%
  - 1966-67: 0.35%
  - 1968-69: 0.40%
  - 1970-71: 0.45%
  - 1972-73: 0.50%
  - 1974-75: 0.55%
  - 1976-77: 0.60%
  - 1978-79: 0.65%
  - 1980-81: 0.70%
  - 1982-83: 0.75%
  - 1984-85: 0.80%
  - 1986-87: 0.85%
  - 1988-89: 0.90%
  - 1990-91: 0.95%
  - 1992-93: 1.00%
  - 1994-95: 1.05%
  - 1996-97: 1.10%
  - 1998-99: 1.15%
  - 2000-01: 1.20%
  - 2002-03: 1.25%
  - 2004-05: 1.30%
  - 2006-07*: 1.35%

* 2005-06 estimated and 2006-07 projected.

Source: California Budget Project calculations from Legislative Analyst’s Office, Calif. Dept of Finance, and Calif Board of Equalization data.

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**Per Capita Gas Tax Collections Have Declined**

- Source: California Budget Project calculations from Board of Equalization and Department of

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**The Telecommunications Revolution**

- Convergence/emergence of new technologies and services: wireless, satellite, fiber-optic, IP (internet).
- California city/county revenues at risk:
  - TV/Cable Franchises $250 million
  - Utility User Taxes on
    - Telephone $700 million
    - TV/Cable $45 million
What’s Wrong?

1. Loss of local fiscal control and home rule: loss of accountability & responsiveness as service levels have declined
   - Decline of discretionary funding for key city services
   - Revenue instability & constraints hamper good governance
2. Fragmentation of finance and governance – frozen property tax allocations - some don’t make sense any more
3. Disconnect between service costs and revenues in urban development imperils city services and deters balanced planning.

Decline of Local $ Predictability

✓ Prop 13 slashed #1 source of local $ and gave authority to allocate the rest to legislature
✓ Voters have imposed more historic limitations on local government revenue raising: Prop 13, Prop 62, Prop 218, etc.
✓ Cities faced
  - Uncertainty about resources
  - Vulnerability to state-level budget cycles
  - Loss of rate setting powers on key revenues
  - Loss of local accountability - ability to respond
  - Decline of home rule - state intrusion into local policy
✓ Prop 1A (Nov 2004) a Major Remedy

Fragmentation of Local Finance and Governance

✓ Multiple overlapping local agencies
✓ Old tax allocation formulas - may not be the most efficient or preferred allocation now
✓ Decline of general purpose government policy making authority due to fragmentation of policy and finance among too many local authorities
3 Portions of Local Fiscal Structure not Sustainable

Some components of California's local government fiscal structure do not adequately respond to social and technical changes.

✓ The sustainability of some local revenues is threatened as social and technical changes result in reductions in the tax base.
✓ Political and legal constraints make it difficult for governments to adjust revenue rules to respond to social and technical changes.

4 Cost & Revenue Disconnect in Urban Development

➢ Revenues from non-retail development often don't cover service costs.
➢ Per capita revenues directly support residential services, but after the VLF-PropTax Swap, very little city revenue is allocated by population.
➢ State cuts of local revenues and tax limits have cities seeking other revenues,
  • sales tax revenue gains from retail are tangible
  • housing, industrial uses often cost more in public services than they generate in tax revenues
  • in non-full service cities, much property tax revenue goes to special districts, less to the city, creating even greater dependence on other revenues, especially sales tax to fund police, parks, planning etc.

Resources …


... and more at CaliforniaCityFinance.com