A Voyage Into the Strange World of California Municipal Finance

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CaliforniaCityFinance.com • The California Local Government Finance Almanac
A Field Guide to Local Governments

Cities
✓ general purpose
✓ essential frontline services tailored to needs of their communities
✓ are funded mostly by locally enacted revenues
✓ provide land use planning & control

Counties
✓ Hybrid local/state
   ▪ state/federal health & social svcs (CalWORKS, foster care, IHSS, etc.)
   ▪ countywide local services (jails, courts, elections, indigent aid, etc.)
   ▪ “city” services to unincorp. areas
✓ More mandates, less discretionary $

Special Districts
✓ “dependent” / “independent”
✓ Enterprise: water, irrigation, sanitation
✓ & not: parks & rec, mosquito abatement, fire
✓ many get a cut of the property tax

Who decides?
- Statewide voters / Constitution
- State law / Legislature
- Local voters
- Local law / City Council

Who pays?
- visitors, residents, businesses, etc.

What rate / base?
- $ per gallon, % per price, depreciated value, etc.

How’s it allocated?
- situs; pooled/population, etc.

What is the $ used for?
- general, water, roads, parks etc.

Who collects & enforces payment?

The Mechanics of Government Revenue
Cities Vary    Counties Vary    Special Districts Vary    ... and so do their finances.

- Geography: proximity, climate, terrain, access
- Community Character / Vision: Land use
- Size – urban / rural
- Governance / service responsibilities
  full service city - vs.- not full service
- Counties – amount of urban devpmt in unincorporation

- Statewide generalizations often mask trends among sub-groups

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Taxes

- Charges which pay for public services and facilities that provide general benefits. No need for a direct relationship between a taxpayer’s 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.
- General & Special
  - General Tax - revenues may be used for any purpose.
  - Majority voter approval required for new or increased local tax
  - Special Taxes - revenues must be used for a specific purpose.
  - 2/3 voter approval required for new or increased local tax
  - Parcel tax - requires 2/3 vote
Any levy, charge or exaction of any kind imposed by a local government, is a **tax** except:

- **User Fees:** for a privilege/benefit, service/product
  - Planning permits, street closure permits, parking permits, user fees, copying fees, etc.

- **Regulatory Fees:** regulation, permits, inspections
  - Permits for regulated commercial activities (e.g., dance hall, bingo, card room, peddlers, catering trucks, massage parlor, firearm dealers, etc.); fire, health, etc.

- **Rents:** charge for entrance, use or rental of government property
  - Facility/room rental fees, equipment rental fees, on and off-street parking, tolls, franchise, museum admission, zoo admission, tipping fees, golf green fees, etc.

- **Penalties for illegal activity, etc.**
  - Parking fines, late payment fees, interest charges and other charges for violation of the law.

- **Charges imposed as a condition of property development**
  - Construction permits, development impact fees, etc.

- **Assessments and property related fees** imposed per Cal Const Article XIII D. (Prop218)

- **A payment that is not “imposed by a local government”**
  - Includes payments made pursuant to a voluntary contract or other agreement that are not otherwise “imposed” by a government's power to coerce.

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**Taxes and Fees/etc. Approval Requirements**

<table>
<thead>
<tr>
<th><strong>TAX- General</strong></th>
<th><strong>TAX- Parcel or Special (earmarked)</strong></th>
<th><strong>G.O.BOND (w/tax)</strong></th>
<th><strong>Fee / fine / rent</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>City / County</td>
<td>Majority voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>Special District</td>
<td>n/a</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>K-14 School</td>
<td>n/a</td>
<td>Two-thirds voter approval (parcel tax)</td>
<td>55% voter approval*</td>
</tr>
<tr>
<td>State</td>
<td>For any law that will increase the taxes of any taxpayer, two-thirds of each house of the Legislature ...or approval of majority of statewide voters.</td>
<td>Statewide majority voter approval</td>
<td>Majority of each house.</td>
</tr>
</tbody>
</table>
California City Revenues

- **Taxes**
  - Property Tax 13%
  - Sales Tax 7%
  - BusnLicTax 2%
  - Utility User Tax 3%
  - TransOccTax 2%
  - Other Tax 3%
  - Franchises 2%
  - State&Fed 1%
  - Other 3%

- **Fees**
  - Benefit Assessments 2%
  - Special Taxes 4%

- **State/Fed Aid**
  - State Grants 4%
  - Federal Grants 5%

- **Rents, penalties**
  - Investments, Rents, Royalties 1%
  - Fines & Forfeitures 1%

- **Other**
  - Licenses & Permits <1%
  - Devpt Fees & Permits 2%
  - Other Fees 12%

- **Property**
  - Not Restricted 35%

- **Utility Fees**
  - (Water, Sewer, Refuse, Electr, Gas, etc.) 28%

- **Other**

Source: CaliforniaCityFinance.com computations from data from California State Controller (revenues).

Source: Coleman Advisory Services computations from State Controller reports

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Discretionary Revenues and Spending

**Typical Full Service City**

- **Property Tax**
- **Sales & Use Tax**
- Franchises
- Utility User Tax
- BusnLic Tax
- Hotel Tax
- Other

- **Expenditures**
  - Fire
  - Police
  - Parks&Rec
  - Library
  - Streets
  - Planning
  - Other

Revenues

Expenditures

Source: Coleman Advisory Services computations from State Controller reports
Counties are hybrid local/state
- **state/federal programs:** Aid to families (CalWORKS), food stamps, foster care, In-Home Support Services (IHSS), alcohol & drug treatment.
- **countywide services:** jails, courts, elections, property tax collection & allocation.
- **“city” services to unincorporated areas**

Counties have
- more mandates,
- less discretionary $, and
- are more vulnerable to state budgetary action.

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**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, whichever is less
- Reassessed to current full value upon change in ownership (with certain exemptions)
- Property that declines in value is reassessed to the lower market value.
- Allocation: shared among cities, counties and school districts according to state law.
Where Your Property Tax Goes

Typical city resident

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

Shares Vary!
- Non-Full service cities: portion of city shares go to special districts (e.g. fire)
- Pre-prop13 tax rates

Source: Coleman Advisory Services computations from Board of Equalization and State Controller data.

Includes Property Tax in-lieu of VLF.

Typical homeowner in a full service city not in a redevelopment area.

Where Your Sales Tax Goes

- State General Fund: 4.1875%
- County Realignment: 1.5625%
- County Transportation: 1/4%
- Prop30**: 1%*
- Prop172 Law Enfrcmt: 1/2%
- Add-On Transactions & Use (varies)

* Local 1% rate includes 1/4% Triple Flip reimbursement.

For taxable sales in unincorporated areas, the local 1% rate goes to the county.

** 1/4% Proposition 30 state sales tax effective 1/1/2013 expires 12/31/2016
Sales Tax Collections

Local 1% Sales Tax Revenue as a Percent of Personal Income
Consumer spending growth is in:
- Housing
- Healthcare
- Food
- Entertainment
- Education

Tax growth is concentrating in distribution centers
Major amounts kicked-back to corporations - not to public services

The population is aging
✓ spending on taxable items declines with age

Some taxable goods being replaced by non-taxed digital equivalents:
✓ computer software
✓ music ✓ movies
✓ games ✓ books

20% to 30% of total local taxes paid statewide are now rebated back to corporations rather than funding public services.
What is the location of the sales transaction (the situs)?

- Seller’s location? Location of product receipt? Product location?
- California currently uses “origin sourcing,” the situs is the retailer’s place of business where negotiations take place.

Origin sourcing often => concentration of tax revenue

- far in excess of service costs at the office or warehouse location
- economic activity, service impacts also occur elsewhere (i.e., where product is used)

To lure jobs and tax revenues, some cities have entered into rebate agreements with corporations.

### Services Commonly Taxed in Other States ... But Not California

<table>
<thead>
<tr>
<th>Service</th>
<th>Texas</th>
<th>Florida</th>
<th>Utah</th>
<th>#States*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional sports (34), amusement parks (34), circus/fairs (33),</td>
<td></td>
<td>X</td>
<td>X</td>
<td>26-34</td>
</tr>
<tr>
<td>cultural events (29), bowling alleys (26)</td>
<td></td>
<td>X</td>
<td>X</td>
<td></td>
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<tr>
<td>Private club memberships, golf</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>23</td>
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<tr>
<td>Health clubs</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>21</td>
</tr>
<tr>
<td>Marina services</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>15</td>
</tr>
<tr>
<td>Laundry / dry cleaning</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>21</td>
</tr>
<tr>
<td>Garment, shoe repair or alteration</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>19</td>
</tr>
<tr>
<td>Automobile repair (20), washing (19), rustproofing (24)</td>
<td></td>
<td>X</td>
<td>X</td>
<td>19-24</td>
</tr>
<tr>
<td>Appliance (incl TV) repair (23), installation (22)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>22-23</td>
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<tr>
<td>Carpet / upholstery cleaning</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>17</td>
</tr>
<tr>
<td>Remodeling – Labor</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>14</td>
</tr>
<tr>
<td>Exterminating</td>
<td>X</td>
<td>X</td>
<td>-</td>
<td>19</td>
</tr>
<tr>
<td>Landscaping / lawncare</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>20</td>
</tr>
<tr>
<td>Swimming pool cleaning</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>16</td>
</tr>
<tr>
<td>Digital downloads</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>23</td>
</tr>
</tbody>
</table>

Source: Mazerov "Expanding Sales Taxation of Services: Options and Issues, Center on Budget and Policy Priorities" *States plus District of Columbia
How We Got Here: the State-Local Relationship

1. One percent rate cap. Property tax rates capped at 1% of full market value
2. Assessment rollback of property values for tax purposes to 1975-76 levels
3. Assessment growth capped at 2% of property value (or CPI) reassessment at full market value only upon change of ownership
4. Special taxes (local) require 2/3 voter approval
5. State tax increases require 2/3 vote of Legislature
6. Authority for allocating property tax revenues transferred to the state

Proposition 13 (1978) nuts & bolts

1. One percent rate cap. Property tax rates capped at 1% of full market value
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Proposition 13 Winners

- Federal Govt: 22%
- Homeowners: 24%
- State Govt: 14%
- Commercial / Rental: 40%

The AB8 (1979) Bailout

Shifting Local Property Tax to Cushion Impacts of Prop13

- State General Fund
- Cities, Counties, Special Districts
- Property Tax
- Schools
California Property Tax

The AB8 “Bailout”: State legislature increased non-school shares, reduced school shares, paid more state general fund to schools.


- Net Loss $940 million
- Net Loss $2,780 million
- Net Loss $350 million
- Net Loss $590 million

Cities, Counties, Special Districts
Are Incorporations and Annexations Extinct?

Pernicious Effects of the VLF-Property Tax Swap of 2004

A brief history of the Car Tax (VLF)

- 1935 – State Vehicle License Fee (a tax) established
  - motor vehicles eliminated from the local property tax
  - revenue subvened to cities and counties
- 1981-84 – Legislature diverts hundreds of millions of city & county VLF $
- 1986 – Prop47: VLF must go to cities and counties
  - but Legislature still decides the rate, the tax base and the allocation
- 1998 - Legislature & Gov Wilson pass VLF cut with backfill for cities & counties
- 2003 – Gray Davis admin pulls trigger, raises VLF
  - Davis Recalled, Schwarzenegger elected & cuts VLF without a funding source, punching a $4 billion ongoing hole in the state budget.
- 2004 – Legislature & Gov Schwarzenegger adopt VLF-Property Tax Swap and protect the property tax in Proposition 1A
The VLF-Property Tax Swap of 2004

$4.4 b* in FY2004-05

VLF Backfill

Cities & Counties

Property Tax in Lieu of VLF

State General Fund

$4.4 b

Schools

* in FY2004-05

If incorporated before 2004 swap

VLF "Bump" Declines to zero over 5 yrs

Swapped for PropTax in 2004

AB1602 to zero over 5 yrs

Special

Actual (after SB89 shift)

City of Jurupa Valley General Fund

$0.0 $5.0 $10.0 $15.0 $20.0 $25.0 $30.0

Millions

VLF Franchise Fees Licenses/Permits SalesTax Property Tax

AB1602 Franchise Fees Licenses/Permits SalesTax Property Tax

Other Franchise Fees Licenses/Permits SalesTax Property Tax

The Lack of VLF Replacement Makes New Cities Fiscally Unviable
Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Over-reliance on redevelopment revenues
- Unsustainable and Intractable employee compensation especially public safety pension and retiree health care
- Risky financing schemes
- Unsustainable Decline in Core Revenues
- Ceding of management and policy choices to others
- Fear & Denial
- Toxic relationships

The Cost of Doing Business
CalPERS Payments on the Rise

Average Employer Contribution Payments
Percentage of Payroll

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>0%</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>25%</td>
<td>30%</td>
</tr>
</tbody>
</table>

Safety (police, fire) plans
Miscellaneous plans
The Cost of Doing Business

CalPERS Payments on the Rise

Projected CalPERS Employer Contribution Payments

Rates up half again or double since 2009

Source: Bartel Associates

CaliforniaCityFinance.com
April 3, 2015
The Cost of Doing Business

Retiree Health Care Costs & other OPEB*

huge unfunded liabilities for many agencies

- Number of retirees continues to rise
- Retirees living longer
- Healthcare costs continue to rise

Alameda County Cities 2013 Task Force Study
- OPEB liabilities are often unfunded
- Unfunded liabilities are 7% to 140% of General Fund
- Among the 14 Alameda County cities
- OPEB* costs increased 45% over 5 years (2008-2013)

The Cost of Doing Business:

Retiree Health Care Costs & other OPEB*

Alameda County Cities Unfunded OPEB Liability

Solutions?
- Pre-fund OPEB liabilities
- Adjust benefits (retirement age, benefit cap, etc)
- Transition to defined contribution plans
- Buy out employee benefits
- Explore use of the Affordable Care Act

Percent of General Fund 6/30/2013

Union City 18%
San Leandro 21%
Piedmont 52%
Pleasanton 105%
Oakland 118%
Livermore 13%
Alameda 68%
Fremont 59%
Hayward 18%
Berkeley 15%
Emeryville 13%
Newark 9%
Dublin 7%
Albany 7%

*Other Post Employment Obligations