

THE FISCAL IMPACT OF PROPOSITION 36
THE JARVIS PROPERTY TAX INITIATIVE

SEPTEMBER 25, 1984

LEGISLATIVE ANALYST
STATE OF CALIFORNIA
925 L STREET, SUITE 650
SACRAMENTO, CALIFORNIA 95814

THE FISCAL IMPACT OF PROPOSITION 36--
THE JARVIS PROPERTY TAX INITIATIVE
TESTIMONY BEFORE THE SENATE GOVERNMENTAL ORGANIZATION COMMITTEE
AND THE JOINT COMMITTEE ON THE STATE'S ECONOMY

MR. CHAIRMAN AND MEMBERS:

YOU HAVE REQUESTED THAT WE PRESENT AN OVERVIEW OF HOWARD JARVIS' LATEST INITIATIVE, WHICH IS PROPOSITION 36 ON THE NOVEMBER BALLOT. SPECIFICALLY, YOU HAVE ASKED US TO DISCUSS (1) THE INITIATIVE'S MAJOR PROVISIONS, (2) ITS FISCAL IMPACT ON STATE AND LOCAL GOVERNMENT, AND (3) SOME OF THE MAJOR FISCAL ISSUES THAT WOULD FACE THE LEGISLATURE IF THE VOTERS APPROVE THE MEASURE ON NOVEMBER 6.

BACKGROUND—PROPOSITION 13

IN ORDER TO PLACE PROPOSITION 36 IN CONTEXT, I WOULD LIKE FIRST TO SUMMARIZE THE MAJOR PROVISIONS OF PROPOSITION 13, WHICH WAS APPROVED BY THE VOTERS ON JUNE 6, 1978. AS YOU KNOW, PROPOSITION 13 PROVIDED TAX RELIEF TO PROPERTY OWNERS IN THREE WAYS. FIRST, IT LIMITS THE PROPERTY TAX RATE TO 1 PERCENT OF ASSESSED VALUE, HOWEVER, PROPERTY TAXES NEEDED TO PAY OFF VOTER-APPROVED INDEBTEDNESS ARE NOT SUBJECT TO THIS LIMITATION. SECOND, PROPOSITION 13 ROLLED BACK ASSESSED VALUES TO THEIR 1975 LEVELS, AND LIMITED SUBSEQUENT INCREASES TO 2 PERCENT ANNUALLY. PROPERTY WHICH IS NEWLY CONSTRUCTED OR WHICH CHANGES OWNERSHIP, HOWEVER, IS REAPPRAISED AT FULL MARKET VALUE. FINALLY, IN ORDER TO PREVENT THE STATE AND LOCAL AGENCIES FROM INCREASING OTHER TAXES, PROPOSITION 13 ALSO REQUIRES A TWO-THIRDS VOTE OF THE LEGISLATURE TO INCREASE STATE TAX REVENUES AND A TWO-THIRDS VOTE OF LOCAL VOTERS TO INCREASE LOCAL REVENUES.

BECAUSE PROPOSITION 13'S LANGUAGE IS AMBIGUOUS IN CERTAIN AREAS, ITS ULTIMATE INTERPRETATION HAS BEEN, TO A GREAT EXTENT, LEFT TO THE JUDICIAL BRANCH. FOUR MAJOR COURT DECISIONS HAVE BEEN ISSUED--THE SO-CALLED CARMEN, FARRELL, RICHMOND, AND BARRETT/ARMSTRONG DECISIONS--WHICH ESSENTIALLY HAVE RESULTED IN A LESS RESTRICTIVE SET OF GROUND RULES THAN MIGHT HAVE BEEN THE CASE UNDER ALTERNATIVE INTERPRETATIONS.

MAJOR PROVISIONS OF PROPOSITION 36

PROPOSITION 36 WOULD OVERTURN ALL OF THESE FOUR MAJOR COURT DECISIONS INTERPRETING PROPOSITION 13. IT ALSO WOULD GRANT ADDITIONAL TAX RELIEF TO CERTAIN CLASSES OF TAXPAYERS, AND PLACE MANY ADDITIONAL RESTRICTIONS ON THE ABILITY OF GOVERNMENT AGENCIES TO DETERMINE THE LEVEL OF LOCAL REVENUE COLLECTIONS. THE DISCUSSION WHICH FOLLOWS FOCUSES ON THE MAJOR CHANGES WHICH WOULD OCCUR AS A RESULT OF PROPOSITION 36.

I. ASSESSED VALUES AND PROPERTY TAX REFUNDS

A. ASSESSED VALUES UNDER PROPOSITION 13

PROPOSITION 13 REQUIRED COUNTY ASSESSORS TO SET 1978-79 ASSESSED VALUES FOR REAL PROPERTY AT A LEVEL EQUAL TO THE PROPERTY'S FULL CASH VALUE FOR THE 1975-76 TAX YEAR. AS LONG AS THE PROPEYTY DOES NOT CHANGE OWNERSHIP, ITS ASSESSED VALUE IN SUBSEQUENT YEARS CAN BE INCREASED BY NO MORE THAN 2 PERCENT ANNUALLY. IN IMPLEMENTING PROPOSITION 13, THE LEGISLATURE SPECIFIED THAT COUNTY ASSESSORS WOULD BEGIN TO APPLY THIS INFLATIONARY ADJUSTMENT IN 1976-77. CONSEQUENTLY, THE ASSESSED VALUES OF PROPERTIES IN 1978-79 WOULD BE 6.12 PERCENT HIGHER THAN THE FULL CASH VALUE OF THESE PROPERTIES IN 1975-76. THE LEGISLATURE'S POLICY REGARDING THE APPLICATION OF THE 2 PERCENT INFLATION ADJUSTMENT WAS UPHELD IN THE BARRETT/ARMSTRONG CASE.

B. PROPOSED ADJUSTMENTS AND REFUNDS

PROPOSITION 36 WOULD ELIMINATE ANY INFLATION ADJUSTMENTS THAT WERE MADE TO THE 1975-76 FULL CASH VALUE OF PROPERTY FOR THE PURPOSE OF DETERMINING ITS 1978-79 ASSESSED VALUE. THESE INFLATION ADJUSTMENTS AFFECT THE DETERMINATION OF A PROPERTY'S ASSESSED VALUE FOR 1978-79 AND ALL SUBSEQUENT FISCAL YEARS, UNTIL THE PROPERTY CHANGES OWNERSHIP. THIS IS ILLUSTRATED IN TABLE 1, WHICH SHOWS HOW THE ASSESSED VALUE WOULD BE DETERMINED FOR A PROPERTY WHICH SOLD FOR \$41,000 IN 1975, THE STATEWIDE MEDIAN SALES PRICE FOR AN EXISTING HOME AS OF THAT POINT IN TIME.

TABLE 1
ILLUSTRATION OF 2 PERCENT INFLATION ADJUSTMENT
UNDER PROPOSITION 13 AND UNDER PROPOSITION 36

<u>FISCAL YEAR</u>	<u>PROPOSITION 13 ASSESSED VALUE</u>	<u>PROPOSITION 36 ASSESSED VALUE</u>	<u>PERCENT DIFFERENCE</u>
1978-79	\$43,510	\$41,000	6.12%
1979-80	44,380	41,820	6.12%
1980-81	45,267	42,656	6.12%
1981-82	46,173	43,510	6.12%
1982-83	47,096	44,380	6.12%
1983-84	47,567	44,824	6.12%
1984-85	48,518	45,720	6.12%

AS THE TABLE SHOWS, THE ASSESSED VALUE OF THIS PROPERTY FOR 1978-79 WOULD BE 6.12 PERCENT MORE THAN ITS 1975 VALUE, DUE TO THE 2 PERCENT INFLATION ADJUSTMENTS ADDED TO REFLECT INFLATION OCCURRING BETWEEN 1975-76 AND 1978-79. UNDER EXISTING LAW, PROPERTY WHICH CHANGED HANDS OR WAS NEWLY CONSTRUCTED DURING THAT PERIOD WOULD ALSO SHOW A DIFFERENT VALUE FOR THE 1978-79 ASSESSMENT THAN IT SHOWED FOR THE 1975-76 ASSESSMENT.

THE TABLE ALSO SHOWS THAT THE PROPERTY'S VALUE IS 6.12 PERCENT HIGHER IN EACH SUCCEEDING YEAR THAN IT WOULD BE WITHOUT THESE ADJUSTMENTS.

PROPOSITION 36 REQUIRES THAT ALL TAXES COLLECTED ON ACCOUNT OF THESE ADJUSTMENTS BE REFUNDED, WITH INTEREST AT 13 PERCENT. THUS, COUNTY ASSESSORS WOULD HAVE TO RECOMPUTE THE TAXES DUE FOR EACH YEAR IN THE 1978-79 THROUGH 1984-85 PERIOD, AND REFUND THE DIFFERENCE. THE MEASURE DOES NOT SPECIFY WHEN THESE REFUNDS WOULD HAVE TO BE PAID.

C. A HYPOTHETICAL EXAMPLE

AS AN EXAMPLE OF HOW THESE PROVISIONS WOULD WORK, TAKE THE HYPOTHETICAL CASE OF TWO IDENTICAL HOMES. THE FIRST HOME IS THE HOME USED IN THE PREVIOUS ILLUSTRATION, WHICH WAS PURCHASED BY ITS CURRENT OWNER IN 1975 FOR \$41,000. THE SECOND HOME WAS PURCHASED BY ITS CURRENT OWNER IN 1980, AND ITS PURCHASE PRICE IS IDENTICAL TO THE STATEWIDE MEDIAN SALES PRICE FOR EXISTING HOMES IN 1980, OR ABOUT \$100,000. UNDER CURRENT TAX LAW, THE ASSESSED VALUE OF THE FIRST HOME IN 1984-85 IS ABOUT \$48,518. AT THE STATEWIDE AVERAGE TAX RATE, THE OWNER OF THIS HOME WILL PAY A TAX BILL THIS YEAR OF \$461. THE ASSESSED VALUE OF THE SECOND HOME THIS YEAR WILL BE ABOUT \$107,200, REFLECTING THE FACT THAT THE PROPERTY WAS REASSESSED AT FULL CASH VALUE FOR 1980-81. UNDER CURRENT LAW, THIS PROPERTY OWNER'S 1984-85 TAX BILL IS \$1,113.

PROPOSITION 36 WOULD REDUCE THE ASSESSED VALUE OF THE FIRST HOME FROM \$48,518 TO \$45,720. THAT OWNER'S 1984-85 TAX BILL WOULD BE REDUCED BY \$27, FROM \$461 TO \$434. SINCE WE DON'T EXPECT THE COUNTY ASSESSORS TO BE ABLE TO IMPLEMENT PROPOSITION 36 PRIOR TO 1985-86, THE 1984-85 TAX SAVINGS WOULD BE INCLUDED IN THE REFUNDS TO BE PAID BEGINNING IN 1985-86. THIS PROPERTY OWNER WOULD RECEIVE AT THAT TIME A TOTAL TAX REFUND OR CREDIT OF \$315. THIS AMOUNT REPRESENTS THE ADDITIONAL TAXES THE OWNER PAID SINCE

1978-79 DUE TO THE APPLICATION OF THE INFLATIONARY ADJUSTMENT IN THAT YEAR, PLUS INTEREST AT 13 PERCENT PER YEAR, THROUGH THE 1984-85 TAX YEAR. ASSUMING THIS PROPERTY OWNER DIDN'T SELL, HE WOULD ALSO RECEIVE ONGOING TAX REDUCTIONS ON THE ORDER OF \$35 PER YEAR, BEGINNING IN 1985-86.

THE OWNER OF THE SECOND HOME, HOWEVER, IS NOT ENTITLED TO A REFUND. THIS IS BECAUSE THAT HOME'S ASSESSED VALUE IS BASED ON ITS 1980 MARKET VALUE, NOT ON ANY INFLATIONARY ADJUSTMENTS THAT MAY HAVE BEEN MADE IN 1978-79. IN FACT, THIS OWNER'S PROPERTY TAX BILL WILL ACTUALLY INCREASE BY ABOUT \$10 IN THE FIRST YEAR, FROM \$1,113 TO \$1,123. THIS INCREASE OCCURS BECAUSE LOCAL AGENCIES WHICH ARE RETIRING BONDED DEBT WILL BE REQUIRED BY CURRENT LAW TO INCREASE THEIR PROPERTY TAX RATES IN ORDER TO COMPENSATE FOR THE LOSS OF REVENUE CAUSED BY THE PAYMENT OF PROPERTY TAX REFUNDS TO PROPERTY OWNERS. IN YEARS AFTER 1984-85, THIS HYPOTHETICAL OWNER WOULD REALIZE SOME MINOR TAX SAVINGS, DUE TO THE ELIMINATION OF THE TAXES IMPOSED FOR NONBONDED VOTER APPROVED INDEBTEDNESS.

THIS EXAMPLE IS BASED ON THE STATEWIDE AVERAGE TAX RATE AND REFLECTS THE ELIMINATION OF THE PROPERTY TAX OVERRIDE LEVIES NOW USED TO SUPPORT VOTER-APPROVED BUT NONBONDED DEBT, WHICH WE'LL DISCUSS IN A MOMENT. BECAUSE THE PROPERTY TAX RATE THAT IS CURRENTLY LEVIED FOR RETIREMENT OF VOTER-APPROVED BUT NONBONDED DEBT VARIES CONSIDERABLY AMONG LOCAL JURISDICTIONS, THIS EXAMPLE IS NOT REALLY REPRESENTATIVE OF THE LIKELY EXPERIENCE OF ANY SINGLE TAXPAYER. IN FACT, PROPERTY OWNERS COULD EXPERIENCE VERY SUBSTANTIAL INCREASES OR DECREASES IN THEIR PROPERTY TAX BILLS, DEPENDING UPON WHEN THEY PURCHASED THE PROPERTY AND WHERE THE PROPERTY IS LOCATED. GENERALLY, OWNERS OF PROPERTY PURCHASED PRIOR TO

MARCH 1, 1977, WILL BE ENTITLED TO PROPERTY TAX REFUNDS AND WILL EXPERIENCE ONGOING REDUCTIONS IN THEIR TAX BILLS. THE OWNERS OF PROPERTY PURCHASED AFTER MARCH 1, 1977, WILL NOT BE ENTITLED TO ANY REFUNDS. THIS IS BECAUSE PROPERTY SOLD AFTER THE MARCH 1, 1977, LIEN DATE WOULD HAVE BEEN REAPPRAISED TO ITS MARKET VALUE FOR PURPOSES OF ITS 1978-79 ASSESSMENT. DEPENDING UPON LOCAL TAX RATES, THE TAX BILLS OF THE LATTER GROUP COULD EITHER INCREASE OR DECREASE ON AN ONGOING BASIS. FOR EXAMPLE, THE OWNER OF PROPERTY LOCATED IN THE CITY OF COMPTON, WHICH HAS LEVIES BOTH FOR SUPPORT OF PENSIONS AND FOR THE METROPOLITAN WATER DISTRICT'S CONTRACT WITH THE STATE WATER PROJECT, WOULD EXPERIENCE SIGNIFICANT INITIAL AND ONGOING TAX DECREASES. PROPERTY OWNERS IN SACRAMENTO, HOWEVER, WHICH HAS NEITHER TYPE OF LEVY, WOULD EXPERIENCE SIGNIFICANT INITIAL AND ONGOING TAX INCREASES, BECAUSE THE LOSSES OF ASSESSED VALUE WILL REQUIRE THE CITY TO PERMANENTLY INCREASE ITS TAX RATES FOR RETIREMENT OF VOTER-APPROVED BONDS.

D. PROPERTY TAX REVENUE LOSSES

IN THE AGGREGATE, WE ESTIMATE THAT PROPOSITION 36 WILL REQUIRE LOCAL AGENCIES TO PAY PROPERTY TAX REFUNDS TOTALLING \$1.7 BILLION, INCLUDING \$1.1 BILLION IN TAX REFUNDS AND \$600 MILLION IN INTEREST. THESE PROVISIONS ALSO WOULD RESULT IN AN ONGOING LOSS OF PROPERTY TAX REVENUES OF \$120 MILLION IN 1985-86 AND DECLINING AMOUNTS ANNUALLY THEREAFTER. THESE REVENUE LOSSES WOULD BE BORNE BY LOCAL AGENCIES IN PROPORTION TO THE SHARE OF TOTAL PROPERTY TAX LEVIES THAT EACH HAS RECEIVED SINCE 1978-79. WE ESTIMATE THAT CITIES' SHARE OF THE REFUNDS WILL TOTAL \$185 MILLION. COUNTIES WOULD LOSE \$522 MILLION, SPECIAL DISTRICTS \$133 MILLION, COMMUNITY REDEVELOPMENT AGENCIES \$44 MILLION, COMMUNITY COLLEGES \$73 MILLION, AND K-12 SCHOOL

DISTRICTS \$508 MILLION. THE REMAINING \$232 MILLION IN PROPERTY TAX REFUNDS WILL BE BORNE BY PROPERTY OWNERS, IN THE FORM OF HIGHER PROPERTY TAXES NEEDED TO RETIRE VOTER-APPROVED BONDS.

BASED ON DATA PROVIDED BY THE STATE BOARD OF EQUALIZATION, WE ESTIMATE THAT SLIGHTLY UNDER HALF (45%) OF THE REFUNDS WILL BE PAID TO PAST AND PRESENT HOMEOWNERS. APPROXIMATELY 21 PERCENT WILL BE PAID TO THE OWNERS OF RESIDENTIAL RENTAL PROPERTIES, AND 34 PERCENT TO THE OWNERS OF COMMERCIAL AND INDUSTRIAL PROPERTY.

II. APPRAISAL CHANGES

PROPOSITION 13 PROVIDES THAT THE ASSESSED VALUE OF PROPERTY WHICH IS SOLD OR NEWLY CONSTRUCTED ON OR AFTER MARCH 1, 1975, IS TO BE SET AT ITS MARKET VALUE AT THE TIME OF SALE OR THE DATE THE NEW CONSTRUCTION IS COMPLETED. BOTH THE VOTERS AND THE LEGISLATURE HAVE APPROVED EXEMPTIONS TO THIS REAPPRAISAL REQUIREMENT IN CERTAIN CASES. THESE LAWS EXEMPT THREE CLASSES OF NEW CONSTRUCTION FROM REAPPRAISAL--PROPERTY WHICH HAS BEEN RECONSTRUCTED AFTER A DISASTER, ACTIVE SOLAR ENERGY SYSTEMS, AND CERTAIN SEISMIC SAFETY IMPROVEMENTS. IN ADDITION, PROPERTY WHICH HAS BEEN PURCHASED AS A REPLACEMENT FOR PROPERTY ACQUIRED BY EMINENT DOMAIN PROCEEDINGS IS EXEMPT FROM REAPPRAISAL, AS IS PROPERTY TRANSFERRED BETWEEN SPOUSES OR FROM PARENTS TO MINOR ORPHAN OR DISABLED CHILDREN.

PROPOSITION 36 PROVIDES THAT THE APPRAISED VALUE OF PROPERTY WHICH CHANGES OWNERSHIP OR IS NEWLY CONSTRUCTED MAY NOT EXCEED THE SUM OF:

(1) THE MOST RECENT PRICE AT WHICH THE PROPERTY WAS SOLD, OR FOR PROPERTY LAST PURCHASED BEFORE THE 1976 ASSESSMENT, THE 1975-76 FULL CASH VALUE;

- (2) THE DIRECT COST OF ANY NEW CONSTRUCTION; AND
- (3) ANY APPLICABLE INFLATION ADJUSTMENTS.

THIS PROVISION HAS TWO EFFECTS. FIRST, BY REQUIRING THE USE OF THE SALES PRICE INSTEAD OF MARKET VALUE IN REAPPRAISING NEWLY PURCHASED PROPERTY, THE INITIATIVE WOULD RESULT IN HIGHER APPRAISALS FOR SOME PROPERTIES AND LOWER APPRAISALS FOR OTHERS. ALSO, BY PROHIBITING THE APPRAISED VALUE OF NEW CONSTRUCTION FROM EXCEEDING THE DIRECT COST OF CONSTRUCTION, THE MEASURE GENERALLY WOULD RESULT IN LOWER APPRAISALS FOR THOSE PROPERTIES WHERE NEW CONSTRUCTION HAS TAKEN PLACE.

PROPOSITION 36 ALSO WOULD REMOVE FROM THE CONSTITUTION PROVISIONS THAT WERE ADDED BY SENATE CONSTITUTIONAL AMENDMENT NO. 14 (ROSENTHAL), WHICH WAS PROPOSITION 23 ON THE JUNE 1984 BALLOT. THESE PROVISIONS EXEMPT FROM REAPPRAISAL, FOR A PERIOD OF 15 YEARS, CERTAIN MODIFICATIONS WHICH ARE NEEDED TO COMPLY WITH LOCAL SEISMIC SAFETY ORDINANCES. THE VOTERS APPROVED THESE CHANGES IN JUNE, BUT BECAUSE PROPOSITION 36 WAS DRAFTED IN 1983, ITS AUTHORS GRAFTED THEIR CHANGES INTO ARTICLE XIII A AS IT EXISTED AT THAT TIME. PROPOSITION 36, IN EFFECT, CHAPTERS OUT THE CHANGES MADE BY THE STATE'S VOTERS IN JUNE.

FINALLY, PROPOSITION 36 EXEMPTS FROM REAPPRAISAL ANY PROPERTY WHICH IS TRANSFERRED BY THE OWNER TO HIS OR HER EXTENDED FAMILY MEMBERS, INCLUDING PARENTS, GRANDPARENTS, STEPPARENTS, UNCLES, AUNTS, SPOUSE, STEPCHILDREN, SIBLINGS, LINEAL DESCENDENTS, OR THE GUARDIAN OR TRUSTEE OF ANY OF THESE PERSONS. THE ASSESSED VALUE OF ANY PROPERTY THAT HAS BEEN TRANSFERRED TO THOSE PERSONS SINCE 1975-76 WOULD HAVE TO BE LOWERED, BUT NO REFUNDS WOULD HAVE TO BE PAID.

WE ESTIMATE THAT THE PROVISIONS RELATING TO THE APPRAISAL OF REAL PROPERTY WILL RESULT IN LOSSES OF PROPERTY TAX REVENUE TO LOCAL AGENCIES AND SCHOOL DISTRICTS OF \$400 MILLION IN 1984-85. THESE LOSSES WOULD INCREASE BY MAJOR AMOUNTS IN SUBSEQUENT YEARS.

III. LIMITS ON TAXES TO SUPPORT VOTER-APPROVED DEBT

PROPOSITION 13 PERMITS LOCAL AGENCIES TO LEVY AD VALOPEM PROPERTY TAXES IN EXCESS OF THE 1 PERCENT LIMIT IN ORDER TO PAY OFF INDEBTEDNESS APPROVED BY THE VOTERS PRIOR TO JULY 1, 1978. APPROXIMATELY \$1 BILLION IN PROPERTY TAXES ARE COLLECTED AS A RESULT OF TAX RATES IMPOSED ABOVE THE 1 PERCENT LIMITATION. FOR THE MOST PART, LOCAL AGENCIES USE THIS UNRESTRICTED TAXING POWER TO RETIRE VOTER-APPROVED GENERAL OBLIGATION BONDS. THE COURTS, HOWEVER, HAVE DETERMINED THAT THE TERM "VOTER-APPROVED INDEBTEDNESS" ENCOMPASSES A BROADER CATEGORY OF INDEBTEDNESS THAN SIMPLY BONDED INDEBTEDNESS. AS A RESULT, THERE ARE TWO OTHER MAJOR CATEGORIES OF INDEBTEDNESS FOR WHICH THE LIMIT MAY BE EXCEEDED.

FIRST, THE SUPREME COURT RULED IN CARMEN V. ALVORD THAT LOCAL AGENCIES MAY LEVY UNRESTRICTED PROPERTY TAXES IN ORDER TO SUPPORT CONTRIBUTIONS TO THEIR EMPLOYEES' PENSION PLANS, WHERE THE VOTERS OF THE LOCAL AGENCY HAD GIVEN THEIR APPROVAL TO INCUR LIABILITIES FOR PENSION OBLIGATIONS. ALTHOUGH THE ISSUE IS NOT YET FULLY RESOLVED IN THE COURTS, IT APPEARS THAT LOCAL AGENCIES MAY ACTUALLY LEVY PROPERTY TAXES TO SUPPORT A VARIETY OF VOTER-APPROVED OBLIGATIONS, AS WELL AS PENSION OBLIGATIONS. IN 1983-84, 32 LOCAL AGENCIES LEVIED A TOTAL OF \$60 MILLION FOR SUPPORT OF PENSIONS, PARAMEDIC SERVICES, LEASE PURCHASE CONTRACTS, LIBRARY SERVICES AND ZOO OPERATIONS.

SECOND, IN GOODMAN V. RIVERSIDE AND KERN COUNTY WATER AGENCY V. BOARD OF SUPERVISORS, THE COURTS HAVE ALLOWED WATER AGENCIES TO LEVY PROPERTY TAXES ABOVE THE 1 PERCENT LIMIT IN ORDER TO SUPPORT FINANCIAL OBLIGATIONS THEY INCUR UNDER THEIR CONTRACTS WITH THE STATE WATER PROJECT. IN 1983-84, 18 OF THE STATE'S 31 CONTRACTORS LEVIED A TOTAL OF \$99 MILLION FOR THIS PURPOSE.

PROPOSITION 36 WOULD PROHIBIT LOCAL AGENCIES FROM LEVYING PROPERTY TAXES ABOVE THE 1 PERCENT TAX RATE LIMIT, EXCEPT TO RETIRE GENERAL OBLIGATION BONDS APPROVED BY THE VOTERS PRIOR TO JULY 1, 1978. HENCE, THE INITIATIVE WOULD INVALIDATE ALL EXISTING PROPERTY TAX LEVIES THAT SUPPORT PENSIONS AND OTHER FORMS OF VOTER-APPROVED NONBONDED DEBT, AS WELL AS THE LEVIES THAT SUPPORT WATER AGENCIES' PAYMENTS TO THE STATE WATER PROJECT.

THE IMPACT OF OVERTURNING THE CARMEN DECISION WOULD VARY CONSIDERABLY AMONG LOCAL AGENCIES. ONLY ONE COUNTY (SANTA CLARA) AND 25 CITIES CURRENTLY LEVY A PROPERTY TAX OVERRIDE TO SUPPORT THEIR PENSION CONTRIBUTIONS. WE ARE CURRENTLY CONDUCTING A SURVEY TO DETERMINE HOW MANY OTHER LOCAL AGENCIES ARE ELIGIBLE TO LEVY AN OVERRIDE FOR THIS PURPOSE. OF THE STATE'S LARGEST CITIES, ONLY OAKLAND MAKES USE OF THE CARMEN DECISION TO SUPPORT ITS PENSION PROGRAM, ALTHOUGH THE CITY OF SAN DIEGO LEVIES A PROPERTY TAX TO SUPPORT THE OPERATION OF ITS ZOO.

DESPITE THE FACT THAT FEW LARGE LOCAL AGENCIES MAKE USE OF THE CARMEN DECISION, OVERTURNING THAT DECISION WOULD HAVE SERIOUS FISCAL CONSEQUENCES FOR SEVERAL OF THE CITIES THAT DO LEVY PROPERTY TAXES FOR SUPPORT OF PENSIONS. FOR EXAMPLE, THE CITIES OF COMPTON, EUREKA, EL MONTE, HUNTINGTON PARK, SAN FERNANDO, CLOVERDALE, MAYWOOD, OAKLAND, RIALTO, AND

WATSONVILLE ALL LEVY A PROPERTY TAX RATE IN EXCESS OF 15 CENTS PER \$100 OF ASSESSED VALUE TO FINANCE PENSION CONTRIBUTIONS. THE REVENUES RAISED REPRESENT A SIGNIFICANT CONTRIBUTION TO THE BUDGETS OF THESE AGENCIES. IN ORDER TO FINANCE THEIR PENSION CONTRIBUTIONS, THESE CITIES WOULD BE REQUIRED TO REDIRECT A SUBSTANTIAL PORTION OF THEIR EXISTING GENERAL REVENUES, WHICH CURRENTLY SUPPORT OTHER CITY PROGRAMS.

IV. LIMITS ON BENEFIT ASSESSMENTS AND NON-AD-VALOREM PROPERTY TAXES

LOCAL GOVERNMENT AGENCIES USE SEVERAL OTHER TYPES OF PROPERTY-RELATED TAXES OR ASSESSMENTS FOR GENERAL REVENUE AS WELL AS FOR THE SUPPORT OF SPECIFIC SERVICES OR FACILITIES. ALTHOUGH THESE TAXES OR ASSESSMENTS ARE IMPOSED ON THE OWNERS OF PROPERTY, THEY ARE NOT TREATED AS PROPERTY TAXES FOR PURPOSES OF PROPOSITION 13.

BENEFIT ASSESSMENTS ARE TYPICALLY USED BY LOCAL AGENCIES TO PAY FOR SPECIFIC INFRASTRUCTURE NEEDS, SUCH AS SEWERS, STREETLIGHTS, AND SIDEWALKS. THEY MAY ALSO BE USED TO FINANCE SERVICES, SUCH AS FLOOD CONTROL, POLICE, AND FIRE PROTECTION. LOCAL AGENCIES CURRENTLY COLLECT ABOUT \$250 MILLION PER YEAR FROM THIS SOURCE.

NON-AD VALOREM PROPERTY TAXES ARE TAXES IMPOSED ON PROPERTY ON A BASIS OTHER THAN THE VALUE OF THE PROPERTY. FOR EXAMPLE, THE CITY OF HILLSBOROUGH'S VOTERS APPROVED A TAX OF \$270 PER PARCEL TO PAY FOR INCREASED FIRE PROTECTION. THE DOCUMENTARY TRANSFER TAX, IMPOSED ON TRANSFERS OF REAL PROPERTY, IS ANOTHER EXAMPLE. IT PRESENTLY PRODUCES APPROXIMATELY \$85 MILLION PER YEAR FOR CITIES AND COUNTIES.

PROPOSITION 36, IN EFFECT, PROHIBITS LOCAL AGENCIES FROM IMPOSING, OR CONTINUING TO IMPOSE, BENEFIT ASSESSMENTS WHICH ARE USED TO PAY FOR THE

PROVISION OF SERVICES. ASSESSMENTS WHICH PAY FOR CAPITAL FACILITIES WOULD NOT BE AFFECTED, AS LONG AS THEY ARE IMPOSED ONLY ON LAND, AS OPPOSED TO IMPROVEMENTS. IT ALSO, IN EFFECT, PROHIBITS THE IMPOSITION OF ANY TAXES ON PROPERTY OTHER THAN THE NORMAL AD VALOREM PROPERTY TAX IMPOSED AS A PERCENTAGE OF THE FULL CASH VALUE OF LAND AND BUILDINGS.

AS A RESULT, WE ESTIMATE THAT BENEFIT ASSESSMENT REVENUE COLLECTIONS WOULD BE REDUCED BY ABOUT \$100 MILLION PER YEAR. THESE LOSSES WOULD BE EXPERIENCED PRIMARILY BY FLOOD CONTROL, WATER AND SEWER DISTRICTS. ONE DISTRICT--THE LOS ANGELES COUNTY FLOOD CONTROL DISTRICT--WOULD LOSE APPROXIMATELY \$45 MILLION.

WE HAVE BEEN ABLE TO IDENTIFY ONLY \$8 MILLION IN ANNUAL NON-AD VALOREM PROPERTY TAX COLLECTIONS THAT WOULD BE AFFECTED. ACCORDING TO LEGISLATIVE COUNSEL, THE DOCUMENTARY TRANSFER TAX WOULD NOT BE AFFECTED, BECAUSE IT IS A TAX ON THE PRIVILEGE OF TRANSFERRING PROPERTY AS OPPOSED TO A TAX BASED ON THE OWNERSHIP OF PROPERTY.

V. LIMITS ON FEES

A. EXISTING RESTRICTIONS ON FEES

FEES TO SUPPORT SERVICES OR REGULATORY PROGRAMS MAY BE IMPOSED BY STATUTE, BY LOCAL ORDINANCE AND, IN SOME CASES, BY ADMINISTRATIVE ACTION. IN MANY CASES, STATE LAW LIMITS THE RATE OF SPECIFIC STATE AND LOCAL FEES EITHER BY SPECIFICALLY ESTABLISHING THE RATE TO BE CHARGED, OR BY RESTRICTING THE CHARGE TO THE ESTIMATED REASONABLE COST OF PROVIDING THE SERVICE. IN ADDITION, PROPOSITION 4, WHICH ADDED ARTICLE XIIIB TO THE STATE CONSTITUTION IN 1979, PLACES SOME RESTRICTIONS ON FEES. PROPOSITION 4 PROVIDES THAT THE AMOUNT OF ANY FEE WHICH EXCEEDS THE COST OF PROVIDING

THE SERVICE FOR WHICH IT IS CHARGED MUST BE TREATED AS A TAX FOR PURPOSES OF THE APPROPRIATIONS LIMITS. THAT IS, FEES IN EXCESS OF COST WOULD BE INCLUDED WITHIN THE APPROPRIATIONS FROM THE PROCEEDS OF TAXES, WHICH ARE LIMITED BY PROPOSITION 4. PROPOSITION 13 PLACES NO RESTRICTIONS ON FEES. TAKEN ALL TOGETHER, EXISTING LIMITATIONS ON STATE AND LOCAL FEES ARE CONSIDERABLY LESS THAN THOSE IMPOSED ON TAXES.

B. RESTRICTIONS IMPOSED BY PROPOSITION 36

PROPOSITION 36 WOULD ESTABLISH CONSTITUTIONAL RESTRICTIONS ON ALL FEES CHARGED BY ANY STATE OR LOCAL AGENCY, OR ANY INSTRUMENTALITY OF THE STATE. THE MEASURE DEFINES A "FEE" TO BE A CHARGE IMPOSED ON PERSONS OR PROPERTY FOR EITHER OF THE FOLLOWING PURPOSES:

- (1) TO PAY FOR THE DIRECT COSTS OF SERVICES PROVIDED TO, OR BENEFITS CONFERRED UPON, THE PERSON OR PROPERTY SUBJECT TO THE CHARGE.
- (2) TO PAY FOR THE DIRECT COST OF A REGULATORY PROGRAM UNDER WHICH THE PERSON OR PROPERTY SUBJECT TO THE CHARGE IS REGULATED.

ALL FEES CHARGED BY ANY STATE OR LOCAL AGENCY WOULD BE SUBJECT TO THE FOLLOWING RESTRICTIONS:

- (1) FEES COULD NOT PRODUCE MORE REVENUE THAN AN AMOUNT EQUAL TO THE DIRECT COST OF THE SERVICE OR REGULATORY PROGRAM FOR WHICH THE FEE IS CHARGED. PROPOSITION 36 DOES NOT DEFINE THE TERM "DIRECT COST", SO IT IS NOT POSSIBLE TO ESTIMATE THE IMPACT OF THIS CHANGE. IT IS POSSIBLE THAT "DIRECT COST" COULD BE INTERPRETED TO EXCLUDE SEVERAL TYPES OF EXPENDITURES PRESENTLY SUPPORTED BY FEE COLLECTIONS, SUCH AS BOND RESERVE FUNDS, BUT THIS ISSUE WILL HAVE TO BE RESOLVED BY THE COURTS. HOWEVER, THE MEASURE PROHIBITS THE USE OF FEE REVENUES TO PAY PENSION LIABILITIES.

FOR EXAMPLE, THE STATE HAS A VARIETY OF REGULATORY BOARDS AND COMMISSIONS IN THE DEPARTMENT OF CONSUMER AFFAIRS. MOST OF THESE BOARDS AND COMMISSIONS DERIVE ALL OF THEIR FUNDING SUPPORT FROM FEES LEVIED ON PERSONS SUBJECT TO THEIR REGULATORY PROGRAMS. PROPOSITION 36 WOULD REQUIRE THESE BOARDS AND COMMISSIONS TO SET THEIR FEES AT A RATE WHICH PRODUCES LESS REVENUE THAN IS NECESSARY TO PAY ALL THEIR NORMAL EXPENSES, BECAUSE FEE REVENUE MAY NOT BE USED TO PAY FOR PENSION COSTS. THUS, THE JARVIS INITIATIVE REQUIRES THAT THESE BOARDS AND COMMISSIONS FIND ANOTHER SOURCE OF FUNDS TO USE TO PAY THEIR PENSION CONTRIBUTIONS.

(2) ON OR AFTER AUGUST 15, 1983, NO NEW FEE COULD BE IMPOSED UNLESS THE FEE WAS APPROVED BY A TWO-THIRDS VOTE OF EACH HOUSE OF THE LEGISLATURE (STATE FEES) OR BY A TWO-THIRDS VOTE OF LOCAL VOTERS (LOCAL FEES).

(3) ON AND AFTER AUGUST 15, 1983, ANY INCREASE IN ANY EXISTING FEE WHICH EXCEEDS THE INCREASE IN THE COST-OF-LIVING FOR THE PRIOR 12-MONTH PERIOD IS PROHIBITED, UNLESS THE INCREASE IS APPROVED BY A TWO-THIRDS VOTE OF THE LEGISLATURE (STATE FEES) OR OF LOCAL VOTERS (LOCAL FEES). FOR EXAMPLE, IF A MUNICIPAL UTILITY'S COSTS TO PRODUCE ELECTRICITY INCREASED BY 12 PERCENT, WHILE INFLATION INCREASED BY 5 PERCENT, THE UTILITY'S RATES COULD BE INCREASED BY NO MORE THAN 5 PERCENT WITHOUT A VOTE OF ITS ELECTORATE. WITH VOTER APPROVAL, RATES COULD BE RAISED BY UP TO 12 PERCENT. UNDER NO CIRCUMSTANCES, HOWEVER, COULD THE UTILITY'S RATES BE SET HIGH ENOUGH TO RECOVER ITS FULL COSTS, DUE TO THE PENSION ISSUE DISCUSSED ABOVE.

C. FISCAL IMPACT

WE HAVE BEEN ABLE TO IDENTIFY \$127 MILLION IN STATE FEE REVENUES THAT WOULD BE INVALIDATED BY PROPOSITION 36. OF THIS AMOUNT, \$92 MILLION IS CURRENTLY USED TO SUPPORT PENSION CONTRIBUTIONS, \$32 MILLION REPRESENTS FEES THAT EXCEED THE COST OF SERVICE, AND \$2 MILLION REPRESENTS NEW OR INCREASED FEES. THE STATE AGENCIES EXPERIENCING THE LARGEST REVENUE LOSSES WOULD BE THE CALIFORNIA HIGHWAY PATROL (\$45 MILLION), THE DEPARTMENT OF CONSUMER AFFAIRS (\$23 MILLION), THE UNIVERSITY OF CALIFORNIA (\$21 MILLION), THE CALIFORNIA STATE UNIVERSITY (\$12 MILLION), AND THE PUBLIC UTILITIES COMMISSION (\$12 MILLION). EXAMPLES OF FEES INVOLVED INCLUDE:

- VEHICLE REGISTRATION FEES, A PORTION OF WHICH ARE USED TO FUND PENSION CONTRIBUTIONS FOR THE CALIFORNIA HIGHWAY PATROL (\$45 MILLION);
- VARIOUS FEES IMPOSED BY THE UNIVERSITY OF CALIFORNIA, A PORTION OF WHICH ARE USED TO FUND PENSION CONTRIBUTIONS (\$21 MILLION);
- HOSPITAL PATIENT FEES CHARGED BY THE DEPARTMENT OF DEVELOPMENTAL SERVICES AND THE DEPARTMENT OF MENTAL HEALTH, WHICH ARE USED IN PART TO DEFRAY PENSION CONTRIBUTIONS (\$2,5 MILLION); AND
- SMOG CHECK FEES, IMPOSED BY THE BUREAU OF AUTOMOTIVE REPAIR, WHICH BOTH FUND PENSION CONTRIBUTIONS (\$1,2 MILLION) AND EXCEED THE COST OF THE SERVICE BEING PROVIDED (\$9,8 MILLION).

AT THE LOCAL LEVEL, WE HAVE IDENTIFIED \$299 MILLION IN ANNUAL FEE COLLECTIONS THAT WOULD BE INVALIDATED BY PROPOSITION 36. OF THE TOTAL, \$132 MILLION REPRESENTS REVENUE CURRENTLY SUPPORTING PENSIONS, \$150 MILLION REPRESENTS FEES THAT EXCEED THE COST OF SERVICES, AND \$17 MILLION

REPRESENTS INCREASED FEES. BECAUSE LOCAL AGENCIES COLLECT SO MANY DIFFERENT TYPES OF FEES, IT HAS NOT BEEN POSSIBLE FOR US TO CONDUCT A COMPLETE SURVEY OF LOCAL FEES THAT WOULD BE AFFECTED BY THIS INITIATIVE. CONSEQUENTLY, OUR ESTIMATE OF THE REVENUE LOSS IS CONSERVATIVE. THERE PROBABLY WOULD BE ADDITIONAL BUT AS YET UNIDENTIFIED FEE REVENUE LOSSES OF AT LEAST \$100 MILLION.

THE LION'S SHARE OF LOCAL FEE REVENUE LOSSES WOULD BE EXPERIENCED BY SO-CALLED ENTERPRISE AGENCIES. THESE ARE SPECIAL DISTRICTS, OR CITY OR COUNTY DEPARTMENTS THAT ARE ORGANIZED AND OPERATED LIKE BUSINESSES, IN THE SENSE THAT THEY SELL SERVICES. ENTERPRISE AGENCIES INCLUDE MUNICIPAL UTILITIES (ELECTRIC, WATER, GAS, GARBAGE, SEWERS) AS WELL AS PORTS, TRANSIT AGENCIES, PUBLIC HOSPITALS, AND AIRPORTS. IN 1982-83, THESE AGENCIES' OPERATING REVENUES TOTALLED \$7.7 BILLION. NEARLY ALL OF THIS REVENUE WOULD BE SUBJECT TO THE FEE RESTRICTIONS CONTAINED IN PROPOSITION 36.

WITH RESPECT TO THESE ENTERPRISE AGENCIES, SOME ARE OPERATED ON A FULL COST RECOVERY BASIS, WHILE OTHERS ACTUALLY PRODUCE A PROFIT FOR THEIR PARENT AGENCIES. FOR EXAMPLE, IN 1983-84, ELECTRIC UTILITY REVENUES COLLECTED BY MUNICIPAL UTILITIES EXCEEDED THEIR TOTAL EXPENDITURES BY ABOUT \$120 MILLION. THESE EXCESS REVENUES ARE TYPICALLY AVAILABLE TO THE PARENT AGENCY TO USE FOR GENERAL PURPOSES. FURTHER, ABOUT \$116 MILLION OF THE FEES COLLECTED ARE USED TO DEFRAY PENSION CONTRIBUTIONS. FINALLY, ELECTRIC RATE INCREASES IMPOSED SINCE AUGUST 15, 1983, HAVE, IN SOME CASES, BEEN IN EXCESS OF THE INFLATION RATE, AND OUR ANALYSIS INDICATES THAT THE AMOUNT OF REVENUE COLLECTED WHICH IS ATTRIBUTABLE TO THE RATE INCREASE IN EXCESS OF THE INFLATION RATE IS ABOUT \$17 MILLION. OVERALL, THEN, MUNICIPAL ELECTRIC

UTILITY RATES WOULD HAVE TO BE REDUCED BY OVER \$250 MILLION AS A RESULT OF PROPOSITION 36.

VI. LIMITS ON NEW OR INCREASED TAXES

A. EXISTING LIMITS ON TAXES

PROPOSITION 13 PROVIDES THAT ANY NEW OR INCREASED STATE TAXES MAY BE IMPOSED ONLY THROUGH LEGISLATION ENACTED BY A TWO-THIRDS VOTE OF EACH HOUSE OF THE LEGISLATURE. THIS RESTRICTION APPLIES ONLY TO TAXES THAT ARE ENACTED FOR THE PURPOSE OF RAISING ADDITIONAL REVENUES. THIS RESTRICTION DOES NOT APPLY TO SO-CALLED "WASH" BILLS, IN WHICH AN INCREASE IN ONE TAX IS OFFSET BY A DECREASE IN ANOTHER TAX, RESULTING IN NO NET REVENUE GAIN. THESE BILLS MAY BE ENACTED BY MAJORITY VOTE.

PROPOSITION 13 PROVIDES THAT LOCAL AGENCIES MAY IMPOSE "SPECIAL TAXES" ONLY IF THESE TAXES ARE APPROVED BY A TWO-THIRDS VOTE OF THE AGENCY'S VOTERS. THE COURTS HAVE GREATLY LIMITED THE APPLICATION OF THIS RESTRICTION. IN RICHMOND V. LOS ANGELES COUNTY TRANSPORTATION COMMISSION, (LACTC) THE SUPREME COURT RULED THAT PROPOSITION 13'S RESTRICTION ON "SPECIAL TAXES" DID NOT APPLY TO THAT AGENCY'S 1/2 CENT SALES TAX IMPOSED FOR TRANSIT PURPOSES BECAUSE THE AGENCY WAS NOT A "SPECIAL DISTRICT" FOR PURPOSES OF PROPOSITION 13. IN FARRELL V. SAN FRANCISCO, THE COURT RULED THAT A "SPECIAL TAX" IS A TAX WHICH RAISES REVENUE FOR A SPECIFIC PURPOSE. IN OTHER WORDS, THE COURT PERMITTED LOCAL AGENCIES TO IMPOSE NEW OR INCREASED TAXES WITH MAJORITY VOTES OF THEIR GOVERNING BODIES, SO LONG AS THE TAXES ARE USED FOR GENERAL PURPOSES, NOT SPECIFIC ONES. BECAUSE COUNTIES, SPECIAL DISTRICTS, AND SCHOOL DISTRICTS NEED SPECIFIC STATUTORY AUTHORIZATION TO IMPOSE TAXES, AS A PRACTICAL MATTER, THE FARRELL DECISION PROVIDED THE TAXING POWERS ONLY OF CITIES.

B. RESTRICTIONS IMPOSED BY PROPOSITION 36

PROPOSITION 36 PROVIDES THAT ON OR AFTER AUGUST 15, 1983, THE LEGISLATURE MAY NOT IMPOSE ANY NEW TAX, OR MAKE CHANGES IN ANY EXISTING TAX THAT WOULD INCREASE THE AMOUNT OF TAX PAID BY ANY TAXPAYER, UNLESS IT DOES SO THROUGH AN ACT APPROVED BY A TWO-THIRDS VOTE OF EACH HOUSE OF THE LEGISLATURE. CONSEQUENTLY, LEGISLATION WHICH INCREASES SOME TAXES AND DECREASES OTHERS WOULD REQUIRE A TWO-THIRDS VOTE IN ORDER TO TAKE EFFECT, EVEN IF THE BILL RESULTS IN NO NET REVENUE GAIN. WE HAVE NOT IDENTIFIED ANY EXISTING LEGISLATION THAT WOULD BE INVALIDATED AS A RESULT OF THIS PROVISION.

ACCORDING TO LEGISLATIVE COUNSEL, THESE PROVISIONS CANNOT BE INTERPRETED TO REQUIRE A TWO-THIRDS VOTE FOR A MEASURE WHICH REDUCES STATE INCOME OR SALES TAXES, OR LOCAL PROPERTY TAXES, EVEN THOUGH SUCH A REDUCTION MIGHT INCREASE THE AMOUNT OF STATE OR FEDERAL INCOME TAXES PAID BY SOME TAXPAYERS DUE TO THE DEDUCTIBILITY OF THE TAX.

PROPOSITION 36 ALSO LIMITS THE ABILITY OF LOCAL AGENCIES TO IMPOSE NEW TAXES OR INCREASE EXISTING ONES. ON OR AFTER AUGUST 15, 1983, A LOCAL AGENCY MAY NOT IMPOSE ANY NEW TAX, OR MAKE CHANGES IN ANY EXISTING TAX THAT WOULD INCREASE THE AMOUNT OF TAX PAID BY ANY TAXPAYER, UNLESS TWO-THIRDS OF THE LOCAL ELECTORATE APPROVED THE NEW TAX OR TAX INCREASE.

NEITHER THE LEGISLATURE NOR LOCAL VOTERS, HOWEVER, WOULD BE PERMITTED TO APPROVE ANY NEW OR INCREASED PROPERTY TAXES.

SUMMARY OF FISCAL IMPACT

I. IMPACT ON LOCAL GOVERNMENT

WITH ALL OF THE INITIATIVE'S PROVISIONS TAKEN TOGETHER, WE ESTIMATE THAT PROPOSITION 36 WILL RESULT IN A LOSS OF REVENUES TO LOCAL AGENCIES, OTHER THAN K-12 SCHOOL DISTRICTS, OF APPROXIMATELY \$2.8 BILLION OVER THE TWO-YEAR PERIOD 1984-85 TO 1985-86. THE REVENUE LOSSES EXPERIENCED BY THESE AGENCIES ON AN ANNUAL BASIS, BEGINNING IN 1986-87, WOULD BE ABOUT \$1.1 BILLION. WITH RESPECT TO K-12 SCHOOL DISTRICTS, EXISTING LAW REQUIRES THE STATE TO PROVIDE REPLACEMENT REVENUE, SO WE TREAT THE SCHOOL DISTRICTS' SHARE OF THE PROPERTY TAX REVENUE LOSSES AS AN INCREASED COST TO THE STATE GOVERNMENT.

TABLE 2 SHOWS THE IMPACT OF EACH OF THE INITIATIVE'S MAJOR PROVISIONS ON LOCAL GOVERNMENT REVENUES.

TABLE 2
FISCAL IMPACT OF PROPOSITION 36
ON LOCAL GOVERNMENT^A
(DOLLARS IN MILLIONS)

	<u>1984-85 AND 1985-86</u>	<u>1986-87 AND ONGOING</u>
<u>PROPERTY TAX REVENUE LOSSES</u>		
2 PERCENT ADJUSTMENT	\$1,066	\$79
APPRAISAL CHANGES	494	259
PENSION VOTER APPROVED INDEBTEDNESS	131	67
WATER PROJECT OVERRIDES	216	111
NON-AD VALOREM TAXES	16	8
BENEFIT ASSESSMENTS	<u>206</u>	<u>106</u>
SUBTOTAL	2,219	630
<u>FEE REVENUE LOSSES</u>		
ELECTRIC UTILITIES	437	268
OTHER IDENTIFIED	79	49
UNIDENTIFIED	<u>173</u>	<u>106</u>
SUBTOTAL	689	423
<u>COST INCREASES</u>		
COUNTY ASSESSORS	<u>10</u>	<u>--</u>
TOTALS	\$2,828	\$1,053

A. EXCLUDES K-12 SCHOOL DISTRICTS.

TABLE 2 SHOWS THAT THE LARGEST SOURCE OF REVENUE LOSS TO LOCAL AGENCIES IN THE TWO-YEAR PERIOD 1984-85 TO 1985-86 IS THE PAYMENT OF PROPERTY TAX REFUNDS, BASED ON THE ELIMINATION OF THE 2 PERCENT ADJUSTMENT OF ASSESSED VALUES PRIOR TO PROPOSITION 13. THIS PROVISION ALONE WOULD RESULT IN A REVENUE LOSS TO LOCAL AGENCIES, OTHER THAN SCHOOLS, OF OVER \$1 BILLION. ALTHOUGH PROPOSITION 36 DOES NOT SPECIFY WHEN LOCAL AGENCIES WOULD BE REQUIRED TO PAY THESE REFUNDS, WE HAVE ASSUMED THAT THE REFUNDS WOULD BE PAID DURING THE 1985-86 FISCAL YEAR.

ON AN ONGOING BASIS, THE SOURCE OF THE LARGEST REVENUE LOSSES TO LOCAL AGENCIES IS NOT THE ELIMINATION OF THE 2 PERCENT ADJUSTMENT, BUT INSTEAD THE CHANGES IN THE RULES FOR APPRAISING PROPERTY AND THE RESTRICTIONS ON FEE REVENUE, ESPECIALLY TO MUNICIPAL ELECTRIC UTILITIES. THE VARIOUS APPRAISAL CHANGES WOULD REDUCE LOCAL AGENCIES' PROPERTY TAX REVENUES BY \$259 MILLION ANNUALLY, WHILE THE FEE RESTRICTIONS WOULD RESULT IN ANNUAL REVENUE LOSSES OF AT LEAST \$423 MILLION.

TABLE 3 SHOWS THE IMPACT OF PROPOSITION 36 ON EACH OF THE MAJOR CATEGORIES OF LOCAL GOVERNMENT.

TABLE 3
IMPACT OF PROPOSITION 36
ON LOCAL GOVERNMENT REVENUES
(LOSSES IN MILLIONS)

	<u>1984-85 AND 1985-86</u>	<u>1986-87 AND ONGOING</u>
CITIES	\$925	\$434
COUNTIES	916	224
SPECIAL DISTRICTS	731	312
REDEVELOPMENT AGENCIES	81	22
COMMUNITY COLLEGES	118	26
K-12 DEVELOPER FEES	<u>56</u>	<u>35</u>
TOTALS	\$2,828	\$1,053

TABLE 3 SHOWS THAT ALL CLASSES OF LOCAL GOVERNMENT WOULD EXPERIENCE MAJOR LOSSES OF REVENUE UNDER PROPOSITION 36.

II. IMPACT ON STATE GOVERNMENT

TABLE 4 SUMMARIZES THE FISCAL IMPACT OF PROPOSITION 36 ON THE STATE.

TABLE 4
FISCAL IMPACT OF PROPOSITION 36
ON STATE GENERAL FUND SURPLUS
(DOLLARS IN MILLIONS)

	<u>1984-85 AND 1985-86</u>	<u>1986-87 AND ONGOING</u>
FEE REVENUE LOSSES	-\$220	-\$135
K-12 APPORTIONMENT COST INCREASES	-753	-144
INCOME TAX	<u>+186</u>	<u>+46</u>
TOTAL GENERAL FUND IMPACT	-\$787	-\$233

TABLE 4 SHOWS THAT PROPOSITION 36 WOULD HAVE AN ADVERSE IMPACT ON THE GENERAL FUND TOTALLING \$787 MILLION IN THE TWO-YEAR PERIOD 1984-85 TO 1985-86, AND AN ONGOING LOSS OF \$233 MILLION ANNUALLY. THESE LOSSES ARE ATTRIBUTABLE TO THE LOSS OF STATE FEE REVENUE, AND THE NEED TO REPLACE LOSSES OF PROPERTY TAX REVENUE EXPERIENCED BY K-12 SCHOOL DISTRICTS. UNDER EXISTING LAW, THE STATE IS REQUIRED TO REPLACE THE REVENUE LOSSES EXPERIENCED BY SCHOOL DISTRICTS, DUE TO THE REVENUE LIMIT FUNDING MECHANISM USED TO DETERMINE SCHOOL FUNDING LEVELS.

THESE LOSSES WOULD BE OFFSET PARTIALLY BY GAINS IN PERSONAL INCOME AND BANK AND CORPORATION TAX REVENUES. REVENUE GAINS WOULD OCCUR BECAUSE PROPOSITION 36 WOULD HAVE THE EFFECT OF REDUCING THE AMOUNT OF PROPERTY TAXES THAT TAXPAYERS COULD DEDUCT FROM THEIR TAXABLE INCOME. WE ESTIMATE THAT, OVER THE TWO-YEAR PERIOD 1984-85 TO 1985-86, THE TOTAL NET PROPERTY TAX RELIEF PROVIDED BY THIS MEASURE WOULD TOTAL APPROXIMATELY \$2.66 BILLION. OF THIS AMOUNT, ABOUT \$186 MILLION WOULD BE RETURNED TO THE STATE GOVERNMENT THROUGH HIGHER INCOME TAXES. FURTHER, WE ESTIMATE THAT FEDERAL INCOME TAX REVENUES WOULD BE INCREASED BY APPROXIMATELY \$750 MILLION AS A RESULT OF THIS PROPERTY TAX RELIEF.

MAJOR ISSUES RAISED BY PROPOSITION 36

YOU ALSO ASKED THAT WE DISCUSS SOME OF THE MAJOR ISSUES LIKELY TO CONFRONT THE LEGISLATURE SHOULD PROPOSITION 36 BE APPROVED BY THE VOTERS. OUR DISCUSSION FOCUSES ON THE MAJOR FISCAL POLICY QUESTIONS THAT WOULD BE RAISED IN THE CONTEXT OF IMPLEMENTING PROPOSITION 36.

1. REPLACEMENT REVENUE FOR LOCAL AGENCIES

ONE OF THE ISSUES THAT HAS BEEN RAISED PUBLICLY CONCERNS THE ABILITY OF THE STATE GOVERNMENT TO PROVIDE REPLACEMENT REVENUES FOR LOCAL GOVERNMENT.

AS YOU KNOW, THE STATE PRESENTLY PROVIDES OVER \$7 BILLION A YEAR IN FISCAL RELIEF TO LOCAL AGENCIES TO REPLACE THEIR LOSS OF REVENUE FROM PROPOSITION 13. AS SHOWN IN TABLE 5, SLIGHTLY UNDER HALF OF THIS AMOUNT REPRESENTS REPLACEMENT REVENUE FOR SCHOOL DISTRICTS, AND ABOUT ONE-THIRD REPRESENTS REPLACEMENT REVENUE FOR COUNTIES. THE COST OF THE FISCAL RELIEF PROGRAM HAS GROWN BY OVER 60 PERCENT SINCE ITS INCEPTION IN 1978. THE RECENTLY ENACTED LOCAL FINANCE MEASURES MADE CERTAIN ALTERATIONS IN THE FISCAL RELIEF PROGRAM, THE COST OF THIS PROGRAM WILL CONTINUE TO INCREASE IN FUTURE YEARS.

TABLE 5
 LOCAL FISCAL RELIEF BY TYPE OF LOCAL AGENCY
 1978-79 THROUGH 1984-85
 (IN MILLIONS)

	<u>1978-79</u>	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>	<u>1984-85^A</u>	<u>PERCENT INCREAS 1984-85 OVER 1978-79</u>
CITIES	\$230	\$216	\$280	\$152	\$99 ^B	\$63	\$374	62.6%
COUNTIES	1,512	1,609	1,927	2,095	2,264	2,432	2,717	79.7
SPECIAL DISTRICTS ^C	190	206	243	268	300	323	356	87.4
K-12 EDUCATION ^C	2,193	2,508	2,721	2,989	2,702	3,011	3,409	55.5
COMMUNITY COLLEGES ^C	260	306	329	355	300	335	257	-1.2
TOTALS ^D	\$4,385	\$4,845	\$5,500	\$5,859	\$5,665	\$6,163	\$7,113	62.2%

A. BASED ON 1984 BUDGET AS PROPOSED BY THE GOVERNOR.
 B. INCLUDES LOCAL AGENCY REIMBURSEMENT FUND DISBURSEMENTS.
 C. BASED ON ESTIMATES FROM THE DEPARTMENT OF FINANCE.
 D. DETAILS MAY NOT ADD TO TOTALS DUE TO ROUNDING.

COULD THE STATE PROVIDE ADDITIONAL FISCAL RELIEF TO OFFSET THE LOSS OF REVENUES BROUGHT ABOUT BY PROPOSITION 36? THE ANSWER TO THIS QUESTION ULTIMATELY DEPENDS ON TWO FACTORS:

- GENERAL FUND CONDITION
- COMPETING DEMANDS

GENERAL FUND CONDITION. CURRENTLY, THE STATE'S GENERAL FUND IS HEALTHY. IT WILL END FISCAL YEAR 1984-85 WITH A RESERVE FOR ECONOMIC UNCERTAINTIES IN EXCESS OF \$1 BILLION. AT THIS POINT, WE CANNOT SAY HOW LARGE THE RESERVE WILL BE. THAT WILL DEPEND ON THE ACTIONS TAKEN BY THE GOVERNOR WITH REGARD TO THE BILLS THAT CURRENTLY ARE ON HIS DESK.

WE DO NOT BELIEVE, HOWEVER, THAT THE RESERVE SHOULD BE LOOKED UPON AS A SOURCE OF FUNDS FOR ADDITIONAL FISCAL RELIEF. THESE ARE NOT "SURPLUS" FUNDS; THEY ARE NEEDED TO PROTECT THE BUDGET AGAINST REVENUE SHORTFALLS AND FINANCIAL EMERGENCIES THAT CANNOT BE BUDGETED FOR WITH ANY CERTAINTY.

NEVERTHELESS, IT IS CLEAR THAT THERE IS ROOM IN THE BUDGET THAT COULD BE USED TO INCREASE FISCAL RELIEF TO LOCAL AGENCIES, BUT SUCH INCREASES WOULD BE AT THE EXPENSE OF COMPETING STATE PROGRAMS. WE ESTIMATE THAT IF THE ECONOMY STAYS HEALTHY, THE GAP BETWEEN BASELINE REVENUES AND BASELINE EXPENDITURES COULD BE AS MUCH AS \$1 BILLION IN 1985-86. IF THE ECONOMY FALTERS, HOWEVER, THE MARGIN WOULD BE CONSIDERABLY LESS.

COMPETING DEMANDS. IN 1985-86, THE LEGISLATURE WILL FACE SIGNIFICANT PRESSURE TO PROVIDE MAJOR INCREASED FUNDING FOR SUCH ITEMS AS INFRASTRUCTURE, MANDATES, AND TAX CHANGES (UNITARY), AS WELL AS A VARIETY OF TRADITIONAL PROGRAM CHANGES. MORE IMPORTANTLY, IF PROPOSITION 36 IS APPROVED BY THE VOTERS, \$787 MILLION OF THE "ROOM" IN THE STATE'S BUDGET WOULD DISAPPEAR AUTOMATICALLY.

CONCLUSION. STATE FINANCES WOULD BE SEVERELY STRAINED TO FUND THE \$787 MILLION IN NET REVENUE LOSSES AND INCREASED SCHOOL APPORTIONMENT COSTS RESULTING FROM THE ADOPTION OF THIS MEASURE. IT COULD NOT ALSO FUND THE FULL \$2.8 BILLION LOCAL GOVERNMENT REVENUE LOSS, ALTHOUGH IT MAY BE POSSIBLE TO FUND A SMALL INCREASE IN THE FISCAL RELIEF PROGRAM IF OTHER COMPETING DEMANDS ARE NOT ADDRESSED.

2. SUBSIDIZATION OF SELF-SUPPORTING ACTIVITIES

PROPOSITION 36 WOULD EFFECTIVELY PRECLUDE THE STATE AND ALL LOCAL AGENCIES FROM OPERATING ANY PROGRAMS ON A FULL-COST RECOVERY BASIS, AS A RESULT OF THE INITIATIVE'S FEE RESTRICTIONS. FEES CANNOT BE SET AT LEVELS WHICH PRODUCE MORE REVENUE THAN IS NECESSARY TO FUND THE "DIRECT COST" OF THE PARTICULAR SERVICE, AND THEY MAY NOT BE USED TO FUND PENSION OBLIGATIONS. AS A RESULT, FEES MAY NOT BE SET AT LEVELS SUFFICIENT TO FUND THE FULL COST OF A SERVICE, ALTHOUGH THE INITIATIVE WOULD APPEAR TO ALLOW SPECIAL TAXES TO BE IMPOSED, IN ADDITION TO FEES, IF A TWO-THIRDS VOTE OF THE LEGISLATURE OR LOCAL AGENCY IS OBTAINED.

THIS RAISES THE QUESTION OF HOW THESE FEE-SUPPORTED PROGRAMS WILL BE FINANCED IN FUTURE YEARS. ONE OPTION IS TO PROVIDE GENERAL FUND SUBSIDIES TO FILL THE GAP BETWEEN FEE REVENUES AND PROGRAM COSTS. THIS COURSE OF ACTION WOULD BE CONTRARY TO EXISTING STATE AND LOCAL POLICIES ABOUT FINANCING THESE SERVICES, AS GENERAL TAXPAYERS WOULD BE PAYING FOR SERVICES CONSUMED BY OTHERS. FOR EXAMPLE, GENERAL TAXPAYERS COULD WIND UP HAVING TO SUPPORT THE COST OF PENSIONS FOR BUPEAU OF AUTOMOTIVE REPAIR EMPLOYEES, INSTEAD OF THE SERVICE STATION OPERATORS THAT THE BUREAU REGULATES. ANOTHER OPTION WOULD BE TO CREATE A WHOLE NEW SET OF TAXES WHICH WOULD BE

IMPOSED ON THE TAXPAYERS IN ADDITION TO THE PRESENT FEES, TO PAY FOR THE COST OF THE PENSION CONTRIBUTIONS. THESE PENSION TAXES WOULD REQUIRE A TWO-THIRDS VOTE FOR IMPLEMENTATION.

3. IMPACT ON REVENUE BOND FINANCING

ACCORDING TO A NUMBER OF UNDERWRITERS, THE ABILITY OF THE STATE AND LOCAL AGENCIES TO ISSUE REVENUE BONDS IF PROPOSITION 36 PASSES WOULD BE ELIMINATED. THESE COMPANIES INDICATE THAT THE INITIATIVE'S FEE RESTRICTIONS WOULD PRECLUDE GOVERNMENT AGENCIES FROM PROVIDING THE TYPE OF SECURITY COVENANTS THAT ARE NECESSARY FOR THE SUCCESSFUL MARKETING OF A REVENUE BOND ISSUE. WE BELIEVE THAT A NUMBER OF REVENUE BOND PROGRAMS, SUCH AS LEASE-PURCHASE BONDS, SHOULD NOT BE SIGNIFICANTLY AFFECTED, SINCE THEIR DEBT SERVICE IS NOT DIRECTLY DEPENDENT ON FEE REVENUES. HOWEVER, IN THOSE CASES WHERE FEE REVENUES DIRECTLY SUPPORT THE DEBT SERVICE, SUCH AS SEWERS, IT WOULD APPEAR THAT IT WOULD AT LEAST BE MUCH MORE DIFFICULT AND COSTLY TO ISSUE THEM.

THIS RAISES THE ISSUE OF WHETHER THE ACTIVITIES FINANCED BY THESE BOND PROGRAMS COULD BE CONTINUED, AND IF SO, HOW? TO THE EXTENT THAT THESE BOND PROGRAMS FINANCE THE CONSTRUCTION OF NECESSARY PUBLIC FACILITIES, SUCH AS POWER PLANTS, SEWAGE TREATMENT PLANTS, TRANSPORTATION OF WATER, COLLEGE DORMITORIES AND THE LIKE, THERE WOULD BE A GREAT DEAL OF PRESSURE TO HAVE THE STATE BECOME THE BANKER FOR THESE PROJECTS.