



## Introduction

## LAO Alternatives

## LAO Considerations

Elizabeth G. Hill  
Legislative Analyst

# Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes

In Chapter 94, Statutes of 1999 (AB 676, Brewer), the Legislature declared the existing property tax allocation system to be “serious flawed” and stated its intent to revamp the system in order to: (1) increase taxpayer knowledge, (2) provide greater local control, and (3) correct the skewed land use incentives faced by local governments.

This report highlights five alternatives to improve local finance.

- ❖ **Alternative I: Set Uniform Rates.** Each jurisdiction would be allocated a property tax share based on the services it provides.
- ❖ **Alternative II: Local Control Over ERAF.** Cities and/or counties would be given direct authority over the rate and allocation of a share of the property tax.
- ❖ **Alternative III: Property Taxes for Municipal Services and Schools.** The allocation of every property’s tax bill would be identical—half to local municipal services and half to schools.
- ❖ **Alternative IV: Re-Balance Tax Burden.** Three local revenue sources would be changed significantly in order to provide a sales tax reduction and create local control over property tax rates.
- ❖ **Alternative V: Making Government Make Sense.** The responsibilities of the state and local governments would be realigned to create more efficient program coordination.

The following three considerations are important in improving the chances for local finance reform:

- ❖ **No Perfect Solution Exists.** By acknowledging the tradeoffs inherent in *all* reform proposals, the Legislature can determine which alternative best meets its priorities.
- ❖ **Need for Focused Attention.** The Legislature could create a joint committee charged with evaluating all reform proposals and recommending the best alternative within a specific time period.
- ❖ **Set Aside Funds.** In passing Chapter 94, the Legislature acknowledged the desirability of providing funding to facilitate reform.

February 3, 2000



---

## INTRODUCTION

California’s property owners pay over \$20 billion of property taxes each year. These tax revenues—the third largest source of tax revenues in California—are then allocated among several thousand local governments, pursuant to a complex state statute. While significant legislation pertaining to the property tax allocation system has been enacted over the years, the allocation system is still commonly referred to as “AB 8,” after the bill which first implemented the system—Chapter 282, Statutes of 1979 (L. Greene).

Over the years, the Legislature, local governments, the business community, and the public have become increasingly critical of the state’s property tax allocation system because (1) it does not allocate revenues in a way that reflects modern needs and preferences of local communities and (2) it centralizes authority over local revenues in Sacramento.

To respond to these concerns, the Legislature enacted Chapter 94, Statutes of 1999 (AB 676, Brewer). Chapter 94 declares that California’s system for allocating property taxes is “seriously

flawed” and states legislative intent to revamp the property tax allocation system to:

- ◆ Increase taxpayer knowledge of the allocation of property taxes.
- ◆ Provide greater local control over property tax allocation.
- ◆ Give local governments greater fiscal incentives to approve land developments other than retail developments.

To assist the Legislature in this effort, Chapter 94 directs the Legislative Analyst’s Office (LAO) to develop alternatives for restructuring the property tax allocation system, including one which provides for a minimum property tax share for each county. This report is written in fulfillment of Chapter 94’s requirements.

This report begins with an examination of the problems in the current property tax allocation system and a discussion of the tensions and trade-offs inherent in reform proposals. The report then discusses five alternatives for revamping the “AB 8” system and outlines a process for enacting reform.

## WHAT ARE THE PROBLEMS WITH THE ALLOCATION SYSTEM?

As noted above, Chapter 94 highlights three specific problems with California’s system of property tax allocation. In addition, we have identified some other concerns which are indi-

rectly related to the current allocation system. Figure 1 lists each of these problems, which are discussed in more detail below.

## LACK OF INFORMATION IMPEDES GOVERNMENT ACCOUNTABILITY

Prior to the passage of Proposition 13 by the California voters in 1978, each governmental entity (city, county, special district, and school district) would set a property tax rate annually. This rate would be combined with other local governments' tax rates to form a property owner's property tax bill. The taxpayer's total property tax owed would be determined by summing together the various rates and applying the total to the property's assessed value. Because the rates were connected to a specific government entity and set annually, taxpayers could see what percentage of their property taxes was going to each local government.

To implement Proposition 13, the Legislature enacted the AB 8 property tax allocation system. A single countywide rate of 1 percent replaced the numerous individual government tax rates. Although taxpayers gained the assurance that their rate could not increase from year-to-year, they lost the ability to see which entities receive revenues from their payments.

**Complexity and Variation in Current Property Tax Allocations.** Even if taxpayers today do further research regarding their property tax bill, they are likely to be confused when they find out that the allocation of revenues to any local government:

- ◆ Is based largely on the level of property taxes that it received in the mid-1970s, relative to other local governments in the same county.

- ◆ Generally can not be changed, except by state legislation.
- ◆ Varies significantly across taxpayers in the same county—and in comparison with taxpayers in other parts of the state.

Further information regarding the complexity and variation of the property tax allocation system is provided in Appendix I.

Figure 1

### Property Tax Allocation: Existing Problems

- Lack of Information Impedes Government Accountability**
  - No entity-by-entity rates.
  - Outdated formulas reflect 1970s preferences.
  - Lack of accountability by officials.
- Lack of Local Control**
  - No ability to raise or lower property tax shares.
  - System susceptible to state-controlled revenue shifts.
  - Inability to shift revenues among priorities.
- Skewed Development Incentives**
  - Fiscal incentives encourage retail over other uses.
  - Fiscal incentives encourage proliferation and misuse of redevelopment.
- Other Related Issues**
  - Assessment practices act as barrier to new businesses.
  - Reliance upon nondeductible taxes to finance government services.
  - Competition for resources results in inefficient intergovernmental program coordination.



**Reduced Government Accountability.** In addition to confusing taxpayers about how their tax dollars are distributed, the AB 8 system reduces government accountability. The link between the level of government allocating the tax (the state) and the entity that spends the tax revenues (cities, counties, special districts, and schools) has been severed. So, for example, if a taxpayer is not happy with the level of library services provided by an independent library district, it is difficult to hold the district accountable since the library district is not the agency responsible for determining the level of property tax revenues available for service delivery.

### **LACK OF LOCAL CONTROL**

The same forces that diminish taxpayers' ability to hold their governments accountable also reduce local governments' ability to control their own finances. Local governments lack the fiscal control to use the property tax for its traditional purpose: meeting the ever-changing municipal needs of a community. Local officials have no power to raise or lower their property tax share on an annual basis to reflect the changing needs of their communities.

As the property tax shifts of the early 1990s illustrated, the current state-controlled allocation of revenues leaves local governments vulnerable to changes in their base revenue levels. Even if these shifted funds (or "ERAF" funds, named after the fund into which the money was deposited, the Educational Revenue Augmentation Fund) were returned, local governments would remain susceptible to future revenue shifts. Without local control

of property tax distribution, state redirections of local revenues remains a potential problem.

The state has left the distribution of property tax revenues among local entities largely unchanged since the 1970s. Counties receive a similar proportion of property tax revenues despite many changes to their program responsibilities. Water districts that received property taxes 25 years ago continue to do so, despite a general trend for these and other resource-related services to be funded by user charges rather than general taxes. Local citizens and their elected representatives lack effective fiscal authority to change the allocation of property taxes to reflect their community's current priorities. This problem is especially acute for cities and counties that provide many of their municipal services through independent special districts. If these special districts levied a property tax rate in the 1970s, they typically continue to receive a share of the property tax today.

Finally, if residents desire an enhanced level of a particular service, there is no local forum or mechanism to allow property taxes to be reallocated among local governments to finance this improvement. For example, Orange County currently receives a very low share of property taxes collected within its borders—typically only 4 percent to 7 percent. If Orange County residents and business owners wished to expand county services, they have no practical way to redirect the approximately 3 percent to 4 percent of property taxes currently allocated to water and sanitation districts to pay for this program en-

hancement. Instead, if residents wish to increase overall county services, they would need to finance this improvement through a mechanism such as an assessment or special tax. In this way, the *overall* level of government taxation and expenditures can be higher than it would be if communities had greater local control.

### **SKewed DEVELOPMENT INCENTIVES**

Under California's system of local finance, communities receive increased tax revenues when property is developed. These taxes include: property tax, sales tax, and vehicle license fees (VLF). Typically, when a city (or a county in the unincorporated area) develops its general plan or receives a proposal for property development, it assesses the fiscal impact of the development on the community. Generally, most communities find that they receive the highest level of revenues from retail developments. This is because the state allocates one cent of the sales tax to the jurisdiction where the transaction occurs; this tax is called the Bradley-Burns sales tax and is allocated on a "situs" basis. In contrast, most communities receive only a small share of the property tax and, for residential developments, a modest per-capita allocation from the VLF. Accordingly, industrial, office, housing, and agricultural land uses generally yield much lower tax revenues than retail development.

Not surprisingly given these incentives, many cities and counties have oriented their land use planning and approval process disproportionately towards the development of retail establishments, a process referred to as the "fiscalization of land use." Some communities have even entered

bidding wars with each other in order to attract a large sales tax generating establishment to their jurisdiction. Because the overall *demand* for retail services is not affected by this competition, local government's emphasis on retail development does not significantly increase the total amount of sales taxes collected by governments—or improve the state's overall economy.

The state has a clear interest in promoting land use decisions that lead to an appropriate mix of various land uses. However, the current fiscal structure fails to encourage this balance. The relatively small share of the property tax that cities are allocated, combined with the presence of a local sales tax allocated on a situs basis, disadvantages the approval of new nonretail developments.

Another consequence of the relatively low share of property taxes received from property within their jurisdiction is the proliferation of redevelopment projects. Without redevelopment, a city wishing to spend funds to upgrade a "blighted" area typically would receive less than 20 percent of the growth in assessed value resulting from any economic improvement in the area. However, by creating a redevelopment project for that same area, a city's redevelopment agency is eligible to receive *all* of the growth in assessed value (less statutorily required pass throughs)—funds that would normally accrue to the county, special districts, school districts, and the city's general fund. This ability to reap higher-than-normal property tax revenues from within redevelopment project areas has led to some abuses and questionable declarations of areas as redevelopment projects.



### **THREE RELATED ISSUES**

While Chapter 94 focuses on limited information and accountability to taxpayers, lack of local control, and skewed development incentives as the major problems with the property tax allocation system, there are several other issues which are indirectly related to the allocation system and which constrict California's ability to have a healthy state-local government relationship. Accordingly, when considering alternatives for reforming the AB 8 system, the Legislature may wish to consider solutions that address the following issues as well.

#### **Acquisition Assessment As Barrier to Entry to Market Place**

Proposition 13 instituted major changes to the method by which property is assessed. Before Proposition 13, property was revalued annually to reflect its market value. Proposition 13 instead requires property be assessed only at the time of acquisition and then increased annually at a maximum of 2 percent. Thus, assuming that property values are on the rise, a property owner who has owned property for a long time will pay significantly less in property taxes than a new property owner of an equivalent property.

For residential property, this acquisition value-based system has some policy merit. Specifically, it (1) encourages stable communities and (2) ensures no sharp increases in taxes from year to year (of particular concern for senior citizen homeowners on fixed incomes). At the same time, however, new homeowners—both first-time home buyers and those relocating—bear a disproportion-

ate share of the residential property tax burden. It is only after a number of years of home ownership that the financial benefits of the acquisition assessment system accrue to homeowners.

The same benefits of the acquisition value system exist in terms of commercial and industrial property; however, the disadvantages of this policy for businesses in a competitive economy are somewhat troubling. The system can present an economic barrier to entry for new businesses. If a competitor has been in the same location for a number of years, a new business faces higher operating costs. This can discourage the formation of new businesses and reduce competition.

#### **Reliance Upon Nondeductible Revenues**

California's state and local governments rely on a sales tax levied at a rate higher than in most other states. California households are not able to deduct these taxes against their federal personal income tax liability. Replacing a portion of the revenues collected under California's sales tax with revenues raised from a deductible tax (property tax, income tax, VLF) would result in a net increase in after-tax income for California residents.

#### **Inefficient Program Coordination**

California's residents receive government services from a wide variety of federal, state, and local agencies. Although many services may appear to be provided by a single agency, typically more than one agency is involved in paying for the service, determining how much of the service is provided, and controlling the details of program delivery.

Viewed as a whole, California's existing "system" of government does not work together well to achieve the public's goals. Rather, the different levels of government often have no common mission and work at cross purposes to one another. Governments compete among themselves for resources and to shift program costs to other governments. The public, in turn, finds that they cannot hold any particular agency responsible for the quality of governmental services.

Several years ago, in outlining a proposal for state-local reorganization—"Making Government

Make Sense" (in *The 1993-94 Budget: Perspectives and Issues*)—we concluded that California's existing system of government was dysfunctional. While the Legislature has improved upon this system somewhat in recent years, many problems of inefficient program coordination, counter-productive fiscal incentives, and reduced accountability remain. These problems span a wide variety of areas, including the provision of many social service and criminal justice programs, land use development, and the administration of the property tax collection system.

## WHY IS IT SO DIFFICULT TO IMPROVE THE ALLOCATION SYSTEM?

The problems with the state's property tax allocation system articulated in Chapter 94 are not new or unknown. These problems have been recognized and discussed by countless local government commissions, committees, and working groups for the last 20 years. Despite the large degree of consensus on the problems, enacting reform has proven elusive because it requires making difficult tradeoffs across multiple worthy policy objectives. That is, in most cases, making progress towards one desirable reform objective requires taking a step away from another.

Our review of previous reform efforts highlights four key areas of policy tension inherent in local finance and property tax allocation system reform proposals:

- ◆ Property Tax Rate: Taxpayer Stability *versus* Local Control.
- ◆ Property Tax Allocation: Local *versus* State Control.
- ◆ Focus of Government: Special Purpose Agencies *versus* General Purpose Governments.
- ◆ Local Finance: Reform *versus* Fiscal Stability.

In developing its proposal to revamp property tax allocation, the Legislature will confront these policy tensions—and will need to strike a balance that meets its policy preferences. Below, we begin our discussion of each policy tension with a graphic showing how the *current* local finance system is balanced between the competing policy objectives (indicated by a "▲").



### Property Tax Rate: Taxpayer Stability versus Local Control



The property tax is the only tax in which the maximum rate is set in the State’s Constitution (at 1 percent of assessed value). Decreases in the property tax rate are authorized under state statute, but are difficult to implement. Increases over the base property tax rate may be authorized only for capital purposes and require approval by two-thirds of the local voters. (Proposition 26 on the March 2000 ballot would establish a *majority* vote approval requirement for *school* capital projects.) Combined, these constitutional and statutory provisions provide a very high degree of stability to the taxpayer, but limit local control over the tax rate.

For these reasons, in our chart above, we place an “▲”—representing the current local finance system—much closer to the goal of property tax rate stability than local control. In developing a reform proposal, the Legislature will need to consider the extent to which it wishes to maintain this level of property tax rate stability for all property owners—versus giving communities greater control to increase and decrease their property tax rates.

### Property Tax Allocation: Local versus State Control



Currently, as discussed earlier in this report, the state controls the allocation of local property taxes. (Thus, the graph shows the “▲” next to “State.”) State control of the property tax, however, is a relatively recent development in the state’s history. Between 1910 and 1978, local governments had exclusive control over the allocation of the property tax; before 1910, this authority was shared between state and local governments.

Proposals to reform the property tax allocation system inevitably confront policy tensions between advocates for state and local control. On the one hand, keeping the state in control of property tax allocation allows the state to use the tax in a manner which reflects statewide concerns, such as funding for: education, state-county partnership programs, and newly developing or low-wealth communities. Transferring power over property tax allocation to local communities, on the other hand, would increase the likelihood that the tax revenues are used in a manner consistent with local preferences.

Because California has thousands of local governments, many with overlapping jurisdictions, reorienting the property tax allocation system to give local control requires major change. In general, we find that there are two ways to provide local control:



- ◆ Create a local forum for deciding how property tax revenues collected in a community should be allocated among local governments. The California Constitution Revision Commission, for example, suggested that each county enact a voter-approved charter defining, among other things, how property taxes are to be allocated. Alternatively, the Legislature could allocate a large share of the property tax to a single general purpose government, such as a city, and require the city to allocate the property taxes to other local governments providing services to city residents. By giving this responsibility to a local general purpose government, the allocation of the property tax could be determined annually, in a manner consistent with local priorities.
- ◆ Modify the current 1 percent property tax rate so that each local government sets its own rate. This would allow each government to raise or lower its property tax rate, possibly subject to voter approval or tax increase limitations. This option, of course, would require modification to Proposition 13.

**Focus of Government:  
Special Purpose Agencies versus  
General Purpose Governments**



California allows special purpose governments and agencies to play a major role in providing governmental services, including fire, water, redevelopment, and parks and recreation. Local governments in other states typically have more of these services controlled by a single general purpose government, such as a city or county. Currently, it is not uncommon for a single home or business in California to be served by a dozen special purpose entities, with many of them receiving a share of property tax.

California's property tax allocation system also contains provisions which strengthen the fiscal position of some special purpose agencies. Specifically, state laws permit virtually any city to create a redevelopment agency capable of redirecting property taxes away from general purpose governments. In addition, as we discussed earlier, state laws controlling the allocation of property taxes may have worked to limit the extent that some special purpose governments (such as water and sanitation districts) are shifted from property tax to user-fee financing.

Because California's system of local government grants significant legal authority to special districts and maintains their share of the property tax, the graphic above shows California's system



of local government leaning moderately in favor of special purpose governments.

### **Local Finance: Reform versus Fiscal Stability**



The last of the four policy tensions pertains to fiscal stability. Given the thousands of units of local government, *any* change to the allocation system for property taxes—or to local finance in general—will cause some fiscal disruption to the state or local governments (thereby reducing California’s current level of fiscal stability, at least in the short-term). In confronting this trade-off, many previous reform committees have chosen to favor fiscal stability more than reform. In fact, some previous reform efforts have sought to make improvements under the constraint of complete fiscal neutrality: no individual government would

gain or lose current revenues under the proposal and no taxpayer would pay more. While the goal of maintaining a government’s and taxpayer’s fiscal condition is worthy, we note that there is tension between the goals of improving the system and maintaining the status quo.

In enacting Chapter 94, the Legislature recognized this tension and specified that it “intends to consider allocating an unspecified amount in additional revenues available to cities, counties, and special districts” to mitigate any fiscal disruption. We think this statement by the Legislature was an important recognition of the tension between reform and fiscal stability. While there are various options for the Legislature to consider to minimize the economic disruption (such as phasing in changes, making them optional, or providing increased taxing authority), it is important to note that the goals of local finance improvement and short-term fiscal stability are at odds.

## **WHAT ARE THE ALTERNATIVES?**

In this next section, we describe five alternatives for revamping the property tax allocation system in a manner consistent with the goals stated in Chapter 94. In reviewing these alternatives, we note that they do not represent the only choices for the Legislature, but a look at the spectrum of options available. In addition, in many cases, elements of these alternatives can be modified to alter the emphasis given to any of the competing policy objectives discussed above, or to address other policy objectives of the Legislature.

### **ALTERNATIVE I: SET UNIFORM RATES**

Chapter 94 requires the LAO to consider the option of “establishing a minimum percentage of the property tax to be allocated to each California county.” This concept of assigning local governments a minimum share of the property tax has been discussed over the years. The Legislature took a step in this direction in passing Chapter 1211, Statutes of 1987 (SB 709, Lockyer), guaranteeing a minimum share of property taxes

to certain cities that did not levy a property tax rate (or levied only a very low rate) prior to Proposition 13. The Legislature also has considered bills to increase certain counties' shares of property taxes.

One difficulty associated with these "minimum percentage" proposals is that there is no common set of governmental responsibilities. Some cities, for instance, provide a wide array of services: police, fire, and parks and recreation. Other cities provide public protection and land use planning, but rely on the county or special districts to provide other services to their residents. Similarly, in some counties most people live within the boundaries of full-service cities. Other counties, by serving unincorporated areas, provide municipal services to a large number of their residents. As a result, assigning the same property tax share to all cities and counties disadvantages those local agencies with more service responsibilities. We note, for example, that an analysis performed for the League of California Cities found that, after correcting for their typically lower service obligations, cities with low shares of the property tax often receive a higher share of the property tax than many other cities.

If the Legislature wishes to revamp the property tax allocation to improve uniformity in the distribution of property taxes, the Legislature should acknowledge the differences in local government service obligations. Accordingly, this first alternative outlines a process by which the Legislature could assign shares of the property tax which reflect the number of services provided by the local government.

### How It Would Work

Based on a statewide study of local government costs to provide services, the Legislature could enact a statute assigning specific shares of the property tax for each service. For example, the statute might assign K-14 finance a 50 percent share of the property tax; countywide services a 25 percent share; fire and police/sheriff 10 percent shares each; and library, parks and recreation, and other services a share of the remaining 5 percent.

Any individual government's share of the property tax, in turn, would reflect the number of services it provides. For example, a city that provides a full array of municipal services might receive 25 percent of the property taxes collected within its borders (10 percent each for police and fire, and 5 percent for other services). Conversely, a city that relies more extensively on special districts might receive a 10 percent share (for police services). Similarly, a county might receive 45 percent to 50 percent of the property tax collected from properties in its unincorporated area, but only 25 percent of the property tax in areas included within a city's boundaries.

The Legislature would have many options in implementing this alternative. For example, the Legislature could specify that the scheduled shares apply only:

- ◆ To the *growth* in property taxes, leaving the existing \$20 billion "base" of property taxes allocated as it has in the past.



- ◆ To governments where it would *increase* their share of property taxes.
- ◆ To governments where the current per-capita amount of property taxes is lower than average.

Alternatively, the Legislature could develop a statewide uniform schedule, applicable to only a specific county or counties on a trial basis.

### **Discussion**

Under this alternative, the differences in property tax shares which largely stem from local taxation and governmental organization decisions of a generation ago would be replaced by differences reflecting current service responsibilities. In addition, taxpayers throughout the state would have a much easier task understanding how their tax dollars are distributed, possibly improving local government accountability.

The major disadvantages of this proposal, relative to the goals specified in Chapter 94, pertain to its failure to increase local control or improve development incentives. Specifically, the uniform schedule of property tax shares would be enacted in Sacramento and is unlikely to represent local priorities or the needs of all communities, especially over time. In addition, this alternative does not alter the fiscal incentives local governments face to approve retail land uses. This is because the alternative does not:

- ◆ Decrease the reliance of cities or counties (agencies with the power to approve land developments) on situs-based sales taxes.

- ◆ Necessarily increase city and county reliance upon the property tax, a tax which provides more “neutral” fiscal incentives for local governments.

In terms of the four tensions discussed above, this alternative makes little change from the status quo. The proposal is balanced towards maintaining property tax rate stability, state control over tax allocation, and maintaining the role of special purpose governments. Finally, the extent to which the proposal was balanced towards reform or fiscal stability would depend on the implementation of the measure. For example, if the schedule applied only to the growth in property taxes, the extent of fiscal disruption and reform would be modest.

### **ALTERNATIVE II: LOCAL CONTROL OVER ERAF**

This next alternative focuses more directly on Chapter 94’s goal of increasing local control over the property tax. Specifically, Alternative II gives local governments direct authority and responsibility over part of the property tax rate and its allocation.

#### **How It Would Work**

Currently, about 18 cents of every property tax dollar paid is allocated to the fund created as part of the early 1990s property tax shift, ERAF. Money from ERAF is allocated to K-14 schools in each county. Under this alternative, the state would *reduce* the overall property tax rate from 1 percent of assessed value to 0.9 percent. *Cities, counties, and special districts would not sustain*

any property tax revenue losses as a result of this change. The only effect of the tax reduction would be to decrease revenues allocated to ERAF. The state would be obligated to offset school losses with increased General Fund dollars.

After reducing the property tax rate from 1 percent of assessed value to 0.9 percent, the Legislature would instruct cities and/or counties that it is their decision whether to (1) increase city or county property taxes up to the maximum 1 percent rate and/or (2) pass on the tax cut as property tax relief to property owners in their communities. Figure 2 (see page 14) provides examples of this alternative. As the figure shows, the first step in the alternative is to view the 1 percent rate as the composite of different rates for different local governments. (The rates shown in the figure represent statewide averages.) The second step is for the state to reduce ERAF's share of the property tax. Finally, in the third step, the Legislature gives cities (or cities and counties) authority to increase the rate. While our example shows local governments increasing the rate to the maximum, some local governments would choose not to increase the tax rate, and pass on the tax cut to their residents.

**What Vote Would Be Needed to Increase the Tax Rate?** Provided the maximum property tax rate did not exceed 1 percent, Proposition 218 (Article XIII C, Section 2 [b]) appears to give this tax adjusting authority to city councils and boards of supervisors, without requiring a vote of the local electorate. Should local residents object to their representatives' decisions, local residents

could elect different local officials, or overturn the property tax change using the initiative powers set forth in Proposition 218 (Article XIII C, Section 3). Cities and counties also could choose to place these taxation matters before their local electorate.

**Which Level of Government Would Have Power Over the Tax Rate?** The Legislature would need to designate the extent to which cities and/or counties would have authority over the rate. Absent a constitutional change, we do not believe that special purpose agencies, such as schools or special districts, would have authority to modify the rate.

### Discussion

This alternative makes significant improvements towards one of the goals specified in Chapter 94—increasing local control of property tax allocation. Specifically, it:

- ◆ **Links the Level of Local Taxes With Local Preferences.** Communities that prefer lower taxes can have their property taxes reduced. Communities that prefer higher levels of city or county services can forgo a tax cut and enjoy higher levels of local services. Should local preferences change over time, the local tax rate could change as well.
- ◆ **Focuses Accountability on Locally Elected Officials.** For much of the last two decades, locally elected officials have had limited authority to alter the level of broad-based local taxes. As a result, some of the focus regarding local fiscal affairs has



**Figure 2**

**Local Control Over ERAF**

**STEP 1: CURRENT EFFECTIVE PROPERTY TAX RATES (STATEWIDE AVERAGES)**

	Rate
Schools	.35
ERAF	.18
Counties	.20
Cities	.11
Special districts	.09
Redevelopment	.08
<b>Total</b>	<b>1.00</b>

One way to think about property tax allocation is to consider the 1 percent rate as the composite of different rates for different local governments.

**STEP 2: REDUCE ERAF'S TAX RATE IN EVERY COMMUNITY**

	Current Rate	State Change	Reduced Rate
Schools	.35	—	.35
<b>ERAF</b>	<b>.18</b>	<b>-.10</b>	<b>.08</b>
Counties	.20	—	.20
Cities	.11	—	.11
Special districts	.09	—	.09
Redevelopment	.08	—	.08
<b>Totals</b>	<b>1.00</b>	<b>—</b>	<b>.90</b>

**STEP 3:**

**OPTION A: AUTHORIZE CITIES TO INCREASE TAX RATE**

	Reduced Rate	Local Change	New Rate
Schools	.35	—	.35
ERAF	.08	—	.08
Counties	.20	—	.20
<b>Cities</b>	<b>.11</b>	<b>.10</b>	<b>.21</b>
Special districts	.09	—	.09
Redevelopment	.08	—	.08
<b>Totals</b>	<b>.90</b>	<b>—</b>	<b>1.00</b>

**OPTION B: AUTHORIZE COUNTIES AND CITIES TO INCREASE TAX RATE**

	Reduced Rate	Local Change	New Rate
Schools	.35	—	.35
ERAF	.08	—	.08
<b>Counties</b>	<b>.20</b>	<b>.05</b>	<b>.25</b>
<b>Cities</b>	<b>.11</b>	<b>.05</b>	<b>.16</b>
Special districts	.09	—	.09
Redevelopment	.08	—	.08
<b>Totals</b>	<b>.90</b>	<b>—</b>	<b>1.00</b>

shifted from locally elected officials to state officials and state budgetary actions. This property tax alternative, in contrast, places more fiscal responsibility upon locally elected officials.

This alternative makes less progress towards Chapter 94's other goals. Specifically, taxpayer understanding of the allocation system would be limited because most tax revenues still would be allocated under the AB 8 formulas. In addition, the alternative only modestly improves local government's skewed land use development incentives.

In terms of the tensions discussed earlier, this alternative moderately shifts the balance towards *local control* of the property tax rate and its allocation. In addition, because special purpose government would not gain increased authority, the alternative shifts the focus of government somewhat towards general purpose governments. Finally, in terms of reform versus fiscal stability, this alternative makes improvements, but imposes a cost to the state. Specifically, a 10 percent reduction in the property tax, as outlined here, would cost the state approximately \$2 billion annually. A 5 percent reduction would cost \$1 billion annually.

### **ALTERNATIVE III: PROPERTY TAXES FOR MUNICIPAL SERVICES AND SCHOOLS**

The third alternative significantly revamps and simplifies the property tax allocation system to meet Chapter 94's goals. Specifically, this alternative links the property tax exclusively to two

purposes: (1) municipal services and (2) school finance. Each of these purposes would receive half of the property tax revenues collected from any property.

#### **How It Would Work**

Under this option, the allocation of every property's tax bill would be identical—half to local municipal services and half to schools. For the half allocated to schools, the funds would be deposited into a countywide fund. From this fund, schools throughout the county would receive an allocation. As with current law, the state's General Fund would supplement these funds and schools would be held harmless. For the remaining half of the property tax, the funds would be allocated to the city in which the property is located. For unincorporated areas, the county would receive the funds to carry out its role as the property's municipal service provider. Funds provided to a county for this purpose could not be redirected to pay for general countywide services, such as county jails, public health, and welfare.

City or county (in the case of unincorporated areas) representatives would be responsible for providing (or contracting for) a defined set of municipal services for their residents, such as police, fire, parks, libraries, etc. Cities or counties could elect to allocate a portion of their property taxes to special districts and/or redevelopment agencies. Because this alternative provides such a large share of the property tax to municipal service providers, counties would need a replacement revenue source to pay for countywide



services. This alternative shifts most city Bradley-Burns sales tax and some city VLF revenues to counties for this purpose. Counties would receive sales tax revenues from sales taking place *anywhere* within their borders, not just from sales occurring in unincorporated areas.

### Discussion

This alternative would make considerable gains towards all of Chapter 94's goals. Specifically, the measure provides for:

- ◆ **Simple Allocation System and Local Flexibility.** For taxpayers, understanding their property tax bills and holding their elected officials accountable would become significantly easier. If they were unhappy with the level of support being dedicated to a particular service, their city council or board of supervisors would have the power to redirect resources away from another service. Property taxes formerly allocated to special districts and/or redevelopment agencies would be available to the city or county as general purpose revenues. As a result, municipal service providers (cities and, for unincorporated areas, counties) would control about \$10 billion of property taxes. Local governments, however, would not receive any additional authority to increase or decrease these revenues.
- ◆ **Balanced Land Use Decisions.** By redirecting the Bradley-Burns sales tax (up to \$4 billion) away from cities to counties, the incentives for land use practices that

unduly favor retail establishments would be greatly reduced.

In terms of the tensions outlined earlier in this report, this alternative maintains the current balance towards property tax rate stability, but allows much greater local control over the allocation of property tax revenues. This proposal places a stronger emphasis on general purpose governments. For special districts or redevelopment agencies to continue to receive property tax revenues, the city or county would have to choose to dedicate a portion of their property tax revenues for these services. (In the short run, however, cities may need to allocate some of their property tax revenues to these agencies to meet debt service obligations.)

### ALTERNATIVE IV: RE-BALANCE TAX BURDEN

Under this alternative, a number of revenue sources are changed significantly to: reduce the state's reliance upon nondeductible taxes, provide a more balanced set of local government fiscal incentives regarding land use, give communities local control over the property tax rate and allocation, and reduce the barriers to entry for new businesses under an acquisition-based assessment system. While these goals could be achieved in a number of ways, one approach is outlined below. As summarized in Figure 3, the alternative makes changes to the sales tax, the property tax, and the VLF in achieving its goals.

#### How It Would Work

**Sales Tax Changes.** This alternative reduces the sales tax by \$5 billion (1.25 percent) in order to



(1) reduce a tax which California households can not deduct against their federal income tax liabilities and (2) reduce local governments' incentives to favor retail developments. Because of differential rates across counties, this tax cut would reduce the sales tax rate in Los Angeles County from 8.25 percent to 7 percent, and in Butte County from 7.25 percent to 6 percent.

This composite sales tax reduction of 1.25 percent would come from cutting the:

- ◆ State's sales tax rate by three-quarters of a cent.





- ◆ Local Bradley-Burns sales tax rate by one half cent.

In addition, in order to further correct local government's strong incentives to approve retail developments over housing, half of local governments' remaining Bradley-Burns sales taxes would be allocated on the basis of population, not by where the sale occurs.

These sales tax cuts would have an indirect effect on future VLF rate reductions. As part of the 1998 budget agreement, the VLF was cut permanently by 25 percent, with additional VLF reductions beginning in 2001 if specific revenue levels are reached. (In addition, the Legislature enacted legislation increasing the VLF reduction to a cumulative 35 percent for calendar year 2000 *only*.) To offset the city and county revenue losses associated with these VLF reductions, the state provides cities and counties the same amount of revenues they would have received under prior law; these state General Fund subventions are called the VLF "backfill." Under the VLF legislation, any additional tax reductions that the Legislature enacts reduces, on a dollar-for-

**Figure 3**

**Summary of Alternative IV:  
Re-Balance Tax Burden**

- 
**Reduce Sales Taxes by 1.25 Percent (\$5 Billion)**
  - Reduction split between state (0.75 percent) and local (0.50 percent) rates.
  - Under current law, *state's* loss of revenue would be largely offset by reduced state spending from *future* vehicle license fee (VLF) reductions not going into effect.
- 
**Increase City and County Property Tax Revenues (\$1.3 Billion)**
  - In exchange for the receipt of these new revenues, local governments would forego the revenues from the *existing* VLF backfill.
- 
**Increase Local Control Over Property Tax Rate**
  - Each local entity would be authorized to raise or lower its own property tax rate.
  - Taxpayer protections would include the requirement of a local charter and a 2 percent maximum annual increase.
- 
**Assess Nonresidential Property at Market Value (\$2 Billion)**
  - Business personal property and state assessed property (like public utilities) are already assessed in this manner.



dollar basis, the amount of tax relief provided through *future* VLF reductions. Under this alternative then, the state’s sales tax cut would *replace* the scheduled *future* reductions to the VLF over the base 25 percent reduction. This option, therefore, reduces a nondeductible tax (sales) instead of a deductible one (VLF).

***Increase Property Tax Shares.*** In order to provide more “neutral” land use incentives to local governments, this alternative shifts about \$1.3 billion of property taxes from schools to cities and counties. This redirection of property taxes would increase state General Fund costs for education. To offset these increased state education costs and hold itself harmless, the state would eliminate the \$1.3 billion General Fund VLF backfill associated with the *existing* 25 percent VLF reduction currently allocated to cities and counties. (Taxpayers, however, would continue to receive the 25 percent reduction.) Thus, as a result of this revenue swap, local governments would continue to receive \$1.3 billion in revenues. However, cities and counties would now receive a revenue source which enhances land-use incentives for balanced development (the property tax), as opposed to a state-controlled subvention (VLF backfill).

***Increase Local Control.*** In order to increase taxpayer understanding of their property tax bill and facilitate local allocation decisions, this alternative would split the current 1 percent base property tax rate into a series of individual local government by local government rates. Each local government’s rate would be shown on the prop-

erty owner’s tax bill. The total of these rates for any property would sum to 1 percent initially.

The Constitution would be amended to specify that this maximum aggregate rate of 1 percent applies in all parts of the state—*unless* it is superseded by a voter-approved local government charter which specifies a process by which the local government’s property tax rate may be increased or decreased. (For example, one city’s local charter could specify that property tax rate changes are permitted upon a two-thirds vote of the electorate, while another city’s charter could require a majority vote of the governing board.) The Constitution would specify, however, that no local government would be permitted to raise its rate by more than 2 percent per year—for instance, from 0.50 percent to 0.51 percent. (There could be exceptions to this limit in cases where a local government was absorbing program responsibilities formerly provided by another government, such as a special district.) Thus, communities would gain a mechanism for increasing and decreasing the level of property taxes allocated to any jurisdiction. At the same time, homeowners would continue to be protected from large year-to-year changes in their property tax bills.

***Reduce Barrier to Entry for New Businesses.*** Finally, in order to address the problem associated with higher property taxes paid by new businesses, this alternative calls for assessing all *nonresidential* property at its current market value. Business personal property and state assessed property (like public utilities) are already assessed in this manner. This change in assessment prac-

tices would likely generate about \$2 billion in additional property taxes in the first year. Revenues in subsequent years would vary with economic conditions.

### **Discussion**

The combination of changes proposed by this alternative would yield an improved system of local government finance that relies less on the sales tax and returns control over the property tax to local governments.

***How Would Individuals Fare Under this Alternative?*** This alternative would give a sizable tax reduction to individuals in the form of a sales tax reduction. While taxpayers would forego *additional* VLF reductions, the sales tax reduction would be about twice as large as the future VLF cuts. Furthermore, VLF payments are deductible for many taxpayers whereas sales tax payments are not. In addition, taxpayers would be able to see the current allocation of the property tax through entity-by-entity rates and decide whether that allocation met their preferences. Each community could decide for itself whether it wanted to maintain the one percent rate cap or opt for a modest modification. Communities would also have a much easier task reallocating revenues, or eliminating the property tax share allocated to some local governments.

***How Would Businesses Fare Under this Alternative?*** Under the current property tax system, business properties—on average—are assessed at about 80 percent of market value. Thus, the change in assessment practices would increase

their property tax liabilities by about 25 percent. This increase in property tax liability, however, would be significantly offset by a large decrease in sales tax liability. Thus, businesses, on average, could expect to pay approximately the same amount of taxes as today. Unlike the current system, however, new businesses would not be at a competitive disadvantage with regards to property tax payments.

***How Would Governments Fare Under this Alternative?*** Local governments in the aggregate, would be held fiscally neutral under this alternative, even without increasing the base property tax rate. Local government land use incentives also would be significantly improved. The amount of local tax revenues generated from *all* types of land uses would increase because of (1) a transfer of additional property taxes to local governments and (2) the increased property tax revenues from the assessment of nonresidential property at market value.

The state would experience a revenue loss resulting from the sales tax reduction. These state losses would be partially offset, however, by increased property taxes associated with the change of assessment for nonresidential property (which would offset state costs for K-14 education) and savings from not implementing further VLF reductions (which would require additional state backfill payments). In total, we estimate that the alternative would likely increase state costs several hundreds of millions of dollars annually.



## **ALTERNATIVE V: MAKING GOVERNMENT MAKE SENSE**

This fifth alternative addresses the goals of Chapter 94 and the problem of inefficient inter-governmental program coordination, discussed earlier in this report. Specifically, this alternative—“Making Government Make Sense” (MGMS) (*1993-94 Budget: Perspectives and Issues*)—provides for significant fiscal changes and a realignment of the duties of state and local government. This alternative illustrates how the issues of local finance, governance, and program reform may be addressed together.

### **How It Would Work**

A series of guiding principles underlie the MGMS proposal and direct its reforms. Specifically:

- ◆ Maximize the separation between state and local duties.
- ◆ Whenever possible, transfer program responsibilities to the level of government closest to the people.
- ◆ Focus state responsibility on programs where uniformity is needed—or where statewide benefits are to be achieved.
- ◆ Ensure that program funding responsibility and program policy control reside at the same level of government.
- ◆ Rely on financial incentives to promote intergovernmental coordination.
- ◆ Match state goals for economic development with fiscal incentives facing local communities.

The MGMS alternative relies upon these principles as it examines each governmental program and assigns principal responsibility for the program to the state—or a *single* local government entity. For most purposes, this alternative eliminates the differences between city and county program responsibilities. Thus, a city is responsible for providing *all* local services to city residents and a county is responsible for providing all services to residents of the unincorporated area. Special districts and redevelopment agencies are not assigned duties by the state, but may be delegated responsibilities by cities or counties.

Alternative V also significantly modifies the state-local financing system to reflect the changes in program responsibility and the statement of principles. Specifically, this alternative shifts a very large share of property taxes from schools to cities and counties to offset (1) the net fiscal effect of the program shifts and (2) a transfer of all of the local Bradley-Burns sales tax to the state. In order to equalize opportunities for community success, each community’s allocation of property taxes would be redetermined by the state. This allocation of property taxes would consider local needs for municipal and community-based services. After this initial allocation by the state, local governments would be authorized to raise or lower their property tax rates by majority vote of the local electorate.

### **Discussion**

This alternative makes significant progress towards the goals specified in Chapter 94. Specifically, taxpayers would have a clear understanding

about the allocation of property taxes—and control over this allocation. The vast majority of any property tax bill would be allocated to a single agency—the city, or county, if the property was in an unincorporated area. Locally elected officials would be responsible for using these property taxes to pay for a wide array of local municipal and community-based services. If taxpayers wished their local government to have a higher or lower level of property taxes, taxpayers could modify the property tax rate accordingly. Finally, by shifting so much property taxes to local government and eliminating local reliance upon

the Bradley-Burns sales tax, this fifth alternative substantially improves local land use incentives.

While this alternative meets all of the goals of Chapter 94 and realigns program responsibilities to focus accountability and achieve greater results, MGMS clearly demonstrates the tension between reform and fiscal stability discussed earlier in this report. Simply put, the alternative entails very significant governance and finance changes. In terms of the other tensions discussed earlier in the report, this alternative emphasizes the goal of local control over the property tax (its rate and allocation) and promotes general purpose governments.

## COMPARING THE ALTERNATIVES

Each of the five alternatives described above would improve upon the current system of property tax allocation. Each alternative addresses at least one of the three major problems with the current property tax allocation system described by Chapter 94—limited accountability to taxpayers, a lack of local control, and skewed development incentives. In Figure 4 (see page 22), we rate these alternatives on their ability to solve these problems, as well as the larger state-local issues of barriers to new businesses, tax deductibility, and intergovernmental program coordination. We have assigned from zero to three checkmarks to each alternative for its ability to solve these problems (with three checkmarks being the best score).

For instance, Alternative III is given three checkmarks for its ability to address skewed

development incentives (since it dramatically increases property tax shares for cities and reduces the situs allocated sales taxes). However, this alternative receives only one checkmark for its ability to enhance local control (although some fiscal flexibility is provided, there is no authority to modify the property tax rate).

An examination of Figure 4 reveals an increasing number of checkmarks as one moves from Alternative I to Alternative V. This is not a coincidence—in order to make significant progress in addressing the stated problems, the alternatives make increasingly dramatic changes to the status quo. For instance, while we believe Alternatives IV and V offer the most progress to a long-term solution to the state-local fiscal relationship, these alternatives come with a cost. In order to imple-



**Figure 4**

**Addressing Tax Allocation Problems: Comparison of Alternatives**

Problem	I. Set Uniform Shares	II. Local Control Over ERAF	III. Property Taxes For Municipal Services And Schools	IV. Re-Balance Tax Burden	V. Making Government Make Sense
Limited accountability to taxpayers	✓	✓	✓✓✓	✓✓✓	✓✓✓
Lack of local control	—	✓✓	✓	✓✓✓	✓✓✓
Skewed development incentives	—	✓	✓✓✓	✓✓✓	✓✓✓
Barrier to new businesses	—	—	—	✓✓✓	—
Reliance on nondeductible taxes	—	—	—	✓✓	—
Inefficient intergovernmental program coordination	—	—	—	—	✓✓✓

Legend:  
 — Does not address problem.    ✓ Some improvement.    ✓✓ Moderate improvement.    ✓✓✓ Significant improvement.

ment these alternatives, both statutory and constitutional changes would be needed that would reduce—at least in the short-term—fiscal stability. For example, Alternative IV and Alternative V

would require changes to the constitutional provisions governing the maximum property tax rate and voter approval requirements.

## MOVING FORWARD TO A SOLUTION

In enacting Chapter 94, the Legislature declared its intent to revamp the state’s system of property tax allocation. Given the policy tradeoffs inherent in the five alternatives and the failures to implement past reform proposals, is there hope for local finance and property tax allocation reform in the near term? We believe there is reason for optimism if the following considerations are kept in mind.

### No Perfect Solution Exists

None of the five alternatives is the perfect solution to California’s property tax allocation problems. Nor will the Legislature find a perfect solution by waiting to take action. In fact, the longer the current system remains unchanged, the worse the problems become. Local governments adjust to the counter-productive fiscal incentives inherent in the current finance system, and resi-

dents turn increasingly to the state to address local concerns. By acknowledging the shortcomings and tradeoffs inherent in all local reform proposals, the Legislature can make an informed determination as to which alternative best meets its priorities.

### **Need for Focused Attention**

If the Legislature considers each reform proposal individually, each proposal likely would be rejected because entities negatively affected by it will mount strong opposition, emphasizing the proposal's imperfections. However, the Legislature could increase the likelihood of enacting reform by (1) creating a joint committee, charged with evaluating all reform proposals and (2) requiring the committee to recommend the best alternative within a specific time period. This focused attention, given to all reform proposals by a single body, would facilitate the process of appraising the strengths and limitations of reform options. This process also would increase the likelihood of compromise, innovation, and ultimately enacting an agreeable solution.

In addition to the alternatives described in this report, the committee could consider proposals from the Speaker's Commission on State/Local Government Finance, the Commission on Local Governance in the 21<sup>st</sup> Century, the Controller, and local government associations. Ideally, the administration would participate in these deliberations given the interest in local government fiscal reform it expressed a year ago.

### **Set Aside Funds**

Given its long-standing concern about improving local finance, the Legislature should consider setting aside a realistic level of one-time and ongoing resources to implement its final reform product. As discussed earlier, many previous reform efforts have failed due in large part to their attempts to be fiscally neutral. Chapter 94, in contrast, acknowledges the desirability of providing resources to facilitate reform. Setting aside funds could ease the transition to a new system. One-time funds could reduce the fiscal impact on local governments during the initial implementation period. Ongoing resources may be needed to implement the long-term structural changes.

The magnitude of dollars needed for this purpose is difficult to determine before the Legislature has developed a local reform proposal reflecting its priorities. Given the billions of tax dollars potentially subject to reallocation and the thousands of local governments involved, however, resources in the range of hundreds of millions of dollars may be necessary to minimize the fiscal disruption associated with local finance reform.

Developing a set-aside of this magnitude would compete with other legislative priorities but need not be solely reliant on new state resources. Rather, the Legislature could consider redirecting some of the local subventions that have been created in recent years (partly in response to the impaired fiscal capacity of local governments). If the Legislature's reform proposal improved local fiscal capacity and accountability, the need for these subventions may be reduced. For example,



---

the Legislature could consider redirecting into a local reform set-aside funds currently budgeted for some of the following programs: the Citizen’s Option for Public Safety (COPS) program, property tax administration loan program, booking fees

reimbursements, redevelopment subventions, and criminal justice grants administered by the Office of Criminal Justice Planning. Combined, the Governor’s budget currently includes over \$300 million for these purposes.

## CONCLUSION

This report outlines five alternatives which would make progress towards the goals articulated in Chapter 94 and local government finance in general. None of these alternatives is perfect; each requires difficult tradeoffs across multiple, worthy policy objectives. In developing a local government reform proposal, the Legislature will confront the tensions between taxpayer stability and local

preferences, local and state control, general purpose and special purpose governments, and reform and fiscal stability. Notwithstanding these tensions, the current year offers a good opportunity for the Legislature to consider making improvements in the property tax allocation and local finance systems.



**APPENDIX I**

**COMPLEXITY AND VARIATION IN PROPERTY TAX ALLOCATION**

Under California law, each area of the state which is served by the same set of local governments is called a “tax rate area” or TRA. Each TRA has its own detailed formula governing the distribution of property taxes collected from within its borders. A sample allocation formula—for a TRA in an older section of Anaheim—is shown in Figure 1. As the figure indicates, if a new business were

constructed in this area, 11 percent of the property taxes would be distributed to the City of Anaheim, 7 percent to the County of Orange, and the rest would be allocated to various school entities and special districts.

Few California cities have only one TRA within its borders; some have dozens. Generally, however, tax distribution formulas associated with TRAs *within* a city are somewhat similar. In contrast, tax formulas assigned to local governments that *cross* city boundaries can vary remarkably. The Rescue Fire Protection District, for example, receives property taxes from 40 TRAs in El Dorado County. In some areas, the fire district receives less than 5 percent of the property taxes; in others, it collects almost 11 percent. The difference in these tax shares does not reflect differences in the level of service the fire district provides, but the implementation of the AB 8 allocation system.

**Variation in Tax Allocation Across County Boundaries**

In addition to this variation within a county, there are remarkable differences in the allocation of property taxes *across* counties. In the case of fire districts, for example, our review of a small sample of California TRAs found fire districts receiving as low as a 4.5 percent share of property taxes and as high as a 32 percent share.

**Figure 1**

**Tax Rate Area Example<sup>a</sup>**

	Percent Share
City of Anaheim	11%
Orange County	7
Orange County Water District	— <sup>b</sup>
Orange County Water District Water Reserve	— <sup>b</sup>
Orange County Transportation Authority	— <sup>b</sup>
Orange County Sanitation District No. 2	3
Orange County Flood Control District	2
Orange County Harbors, Beaches, and Parks	2 <sup>b</sup>
Orange County Vector Control District	— <sup>b</sup>
Orange County Cemetery District	— <sup>b</sup>
Anaheim High General Fund	19
North Orange County Community College	8
Anaheim Elementary	30
Orange County Department of Education	2
ERAF <sup>c</sup> (distributed to various schools)	16
<b>Total</b>	<b>100%</b>

<sup>a</sup> Percentages indicate allocation of taxes from a new home or business in Anaheim tax rate area 01-007.

<sup>b</sup> Less than 1 percent.

<sup>c</sup> Educational Revenue Augmentation Fund.



To illustrate this variation in the property tax allocations among local governments, Figure 2 displays tax allocation formulas for various TRAs across the state. Specifically, the figure shows how property taxes collected from a new home or business are distributed to: K-14 schools, cities, counties, and “other” local governments (special districts and city- or county-controlled library and fire districts).

**School Shares.** K-14 education’s share of property taxes in our figure ranges from a low of 23 percent in the City of Industry to a high of 78 percent in an unincorporated area of Santa Clara. It is important to note that this variation does *not* alter the amount of revenues available to schools in these areas. This is because, under the state’s school funding formulas, higher allocations of property taxes to school districts simply reduce the amount of state education assistance. Thus, the real effect of this variation in school property taxes is the varia-

tion in the residual amount of property taxes available for nonschool local programs.

**Figure 2**

**How Are Property Taxes Allocated?**

Sample Area <sup>a</sup>	Property Tax Shares				
	County	Schools	City	County	Other
Chico <sup>b</sup>	Butte	58%	16%	19%	7%
Oroville <sup>b</sup>	Butte	49	24	16	11
Lafayette	Contra Costa	55	6	10	29
Walnut Creek	Contra Costa	54	9	14	23
Placerville	El Dorado	58	4	21	17
South Lake Tahoe	El Dorado	48	18	21	13
South Lake Tahoe <sup>b</sup>	El Dorado	35	22	29	14
Unincorporated Industry <sup>b</sup>	El Dorado	50	—	19	31
Los Angeles	Los Angeles	23	8	47	21
Los Angeles	Los Angeles	48	26	24	1
Unincorporated Westlake Village	Los Angeles	43	—	33	24
Westlake Village	Los Angeles	44	6	26	24
Anaheim	Orange	74	11	7	9
Fullerton <sup>b</sup>	Orange	71	16	6	7
Irvine	Orange	69	3	6	23
Laguna Hills	Orange	72	5	4	19
Palm Springs	Riverside	56	23	14	8
Rancho Mirage	Riverside	45	—	33	22
Riverside	Riverside	69	12	15	5
Citrus Heights	Sacramento	51	7	16	25
Sacramento <sup>b</sup>	Sacramento	56	26	18	1
Unincorporated Sacramento	Sacramento	43	—	15	43
San Francisco <sup>b</sup>	San Francisco	34	—	65	1
Milpitas <sup>b</sup>	Santa Clara	50	18	24	8
Morgan Hill	Santa Clara	69	11	14	6
Palo Alto	Santa Clara	71	9	16	4
San Jose	Santa Clara	69	13	15	3
Unincorporated	Santa Clara	78	—	15	7
Rohnert Park	Sonoma	59	12	24	6
Santa Rosa	Sonoma	64	11	20	5
Unincorporated Visalia <sup>b</sup>	Tulare	66	—	20	15
Visalia <sup>b</sup>	Tulare	64	12	18	7
Davis	Yolo	66	21	9	4
West Sacramento	Yolo	45	49	3	3

<sup>a</sup> Percentages indicate allocation of taxes from a new home or business in a tax rate area (TRA) of jurisdiction listed. Jurisdictions may have many different TRAs.

<sup>b</sup> Designates that the area is in a redevelopment project. In these areas, the allocation formulas shown are superseded, and most of the growth in property taxes is allocated to the redevelopment agency.

**City Shares.** The figure also shows large variation in the share of property taxes allocated to cities. The City of Irvine, for example, receives about 3 percent of the property taxes collected in this sample neighborhood—less even, than the share of property taxes allocated to the various water districts serving the area's residents. The City of Los Angeles, on the other hand, receives about 26 percent of property taxes collected in this sample area. Most of the variation in these city share percentages reflects: (1) differences in the number of services cities provided before

Proposition 13, (2) the date of city incorporation, and (3) local taxation choices by city residents before Proposition 13.

**County Shares.** The figure shows similar variation among the shares of property taxes allocated to counties and other entities (such as special districts and city- and county-controlled fire and library districts). The unusually high share for other entities in Lafayette, Walnut Creek, and the unincorporated area of Sacramento reflects the relatively large share of property taxes allocated to their fire districts.



### **Acknowledgments**

This report was prepared by Marianne O'Malley and Michael Cohen, under the supervision of Mac Taylor. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.



### **LAO Publications**

To request publications call (916) 445-2375. This report and others, as well as an E-mail subscription service, are available on the LAO's Internet site at [www.lao.ca.gov](http://www.lao.ca.gov). The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.