

December 23, 2009

Hon. Edmund G. Brown Jr.  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Krystal Paris  
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional and statutory initiative related to local government revenue raising and the use of various state and local resources (A.G. File No. 09-0071, Amdt. #1-S).

## **BACKGROUND**

### **Sales Tax**

Currently, local governments (cities and counties) receive a portion of the existing 8.25 percent sales and use tax revenues. (Of this rate, 1 percent is temporary and will expire at the end of 2010-11.) In addition, local agencies may impose a higher sales tax rate in their communities, subject to the approval of their local voters. The Constitution's voter approval threshold depends on how the tax proceeds would be used. Specifically, if the local government would use the tax proceeds for:

- Special or designated purposes, the tax requires approval by two-thirds of local voters.
- General purposes, the tax requires approval by a majority of local voters.

The Constitution allows cities and counties to share sales tax revenues with other cities and counties if the sharing agreement is approved by a majority of local voters or two-thirds of the affected governing bodies.

### **Property Tax**

The Constitution establishes a 1 percent maximum base property tax rate on real property and directs counties to collect these tax revenues and allocate them to local governments (cities, counties, special districts, redevelopment agencies, schools, and community colleges) according to law. While the Legislature may modify property tax

allocation laws, the Legislature generally may not do so if it would decrease the total countywide share of property taxes allocated to cities, counties, and special districts. An exception to this provision is known as a “Proposition 1A (2004) suspension,” after the measure that established this procedure.

***Proposition 1A (2004) Suspension.*** No more than twice in ten years, during a severe state fiscal hardship, the Legislature may reduce city, county, and special district property taxes—and increase school property taxes. Within three years, the Legislature must repay city, county, and special districts for their reduced property tax revenues. In 2009, the Legislature enacted a Proposition 1A suspension, shifting 8 percent of every city, county, and special district’s 2008-09 property taxes to educational agencies—for a total of \$1.9 billion in shifted revenue. The state must repay each local government by June 30, 2013.

### **Tax Increment**

City and county redevelopment agencies may create “project areas” in blighted, urban areas. After a redevelopment agency creates a project area, it receives all the growth in property tax revenues (called the “tax increment”) generated in the area. Other local agencies serving the project area continue to receive the amount of property taxes they received before the agency created the project area.

To partially mitigate the fiscal effect of redevelopment on other local agencies, state law requires most redevelopment agencies to “pass through” a portion of their tax increment to other agencies serving the project area. In addition to these ongoing pass-through obligations, the state periodically has required redevelopment agencies to make payments to schools. Current law, for example, requires redevelopment agencies to contribute to schools \$1.7 billion in 2009-10 and \$350 million in 2010-11.

### **Transportation Funding**

The state currently charges a sales tax on the purchase of gasoline. These sales tax revenues are required to be used for specified transportation purposes, including local street and road improvements, projects that expand capacity on the state’s highway and transit systems, and transit and rail operations. A portion of these revenues is deposited into the Public Transportation Account, with the rest of the revenues going to the General Fund.

The Constitution requires that the gasoline sales tax revenues deposited into the General Fund be transferred to the Transportation Investment Fund (TIF). Over the past five years, this transfer has averaged roughly \$1.4 billion per year. Of these revenues, 20 percent are dedicated to mass transportation purposes, and 40 percent are allocated to the state’s transportation capital improvement program. The other 40 percent are given to cities and counties for local street and road maintenance and improvement. Under certain conditions, the Constitution allows this transfer to be suspended up to

two times over a ten-year period. Suspended amounts, however, must be repaid with interest within three years.

### **Proposition 98**

Adopted by the voters in 1988 and amended in 1990, Proposition 98 establishes a set of formulas that are used to annually calculate a minimum funding level for K-12 school districts and the community colleges. This funding level is met using state General Fund dollars and local property tax revenues.

## **PROPOSAL**

This measure amends the Constitution to (1) authorize county voters to approve—by a majority vote—new sales taxes under certain conditions and (2) constrain the state’s authority to redirect certain state and local resources. We discuss these changes below.

### **Majority Approval of Sales Tax Measures**

Under the measure, a majority of county voters could impose a higher local sales tax rate of up to one cent, based on a county-approved “countywide strategic action plan” as defined by the measure. (Figure 1 summarizes the required elements of this plan.) The new sales tax revenues would be allocated to cities and the county pursuant to the plan. Cities and the county, in turn, would be required to shift to school districts an amount of revenues equal to one-half of the revenues they receive under the new sales tax. Cities and counties could shift any tax revenues to schools to meet this obligation—sales, property, or other local tax. The additional school revenues would be allocated to districts within the county based on enrollment and would not count for purposes of calculating the state’s minimum funding requirement under Proposition 98.

Under the measure, the sales tax would end in ten years, unless (1) a majority of county voters approved a continuation of the tax or (2) a majority of the county governing board agreed to dissolve or amend the countywide strategic action plan earlier.

### **Limitations on State Authority to Redirect Resources**

*Property Tax.* The measure eliminates the state’s authority to shift property taxes from cities, counties, and special districts to schools during a severe state fiscal hardship. Under the measure, the state would maintain responsibility for repaying local governments for the 2009 Proposition 1A (2004) suspension, but could not borrow local funds by shifting property tax revenues to schools in the future.

**Figure 1****Countywide Strategic Action Plan**

- **Identify Community Goals and Outcomes.** Plan must identify community goals and desired outcomes and indicate how progress towards these would be measured and reported.
- **Align Resources With Goals.** Plan must identify how the sales tax revenues, if approved, would be allocated among cities and the county in furtherance of the goals of the plan.
- **Initiate Plan Development and Approval.** A majority of the members of the County Board of Supervisors must vote to initiate development of the plan and adopt the completed plan.
- **Provide Resources for Schools.** Plan must identify a source of local tax revenues to reallocate to school districts if the sales tax is approved. The amount of revenue reallocation must equal one-half the revenues raised under the higher sales tax rate proposed in the plan. Schools would receive revenues based on enrollment.
- **Include City and School Documents.** Cities and schools must include documents indicating their plans for addressing the needs of their communities. These documents become part of the countywide plan and are not subject to county modification.

**Prohibits Borrowing or Redirection of Gasoline Sales Tax Revenues.** The measure prohibits suspending the transfer of gasoline sales tax revenues from the General Fund to the TIF. This eliminates the state's ability to borrow these funds for non-transportation purposes.

**Other Local Revenues.** Under the measure, the Legislature could not enact new laws that require redevelopment agencies to use tax increment funds to make payments to schools or other agencies. The measure also specifies that the Legislature may not reallocate, borrow, or use revenues from any locally imposed tax.

## FISCAL EFFECTS

Under this measure, (1) cities, counties, and schools would have higher and more stable revenues and (2) state revenues would be lower in some years than otherwise would be the case. We discuss these fiscal effects below.

### Higher and More Stable Resources for Local Governments

This measure would make it easier for voters to approve some countywide sales taxes to support city, county, and school programs, compared to the existing two-thirds vote requirement for special taxes. As a result, counties probably would propose more of these measures and voters probably would approve more of them.

California's 2004 election illustrates the potential effect of setting a majority vote threshold for new sales taxes. During that year, local governments proposed 48 sales tax increases for special purposes. Voters approved one-third of them. If the voter approval threshold for these taxes had been 50 percent, over half of these taxes would have been approved. While some of the failed tax measures that earned more than 50 percent approval involved small sums, some were large. For example, the Los Angeles County half-cent sales tax failed because it was approved by only 60 percent of local voters. Had the measure passed, it would have raised about \$600 million annually.

The fiscal effect of this measure's provisions—authorizing majority vote approval for sales taxes to implement specific countywide plans—would depend on future local government and voter decisions. If voters in every county approved the maximum sales tax increase, local government revenues would increase by over \$5 billion—including over \$2.5 billion for schools. Alternatively, if the state's ten most populous counties each approved a one-quarter cent increase, local government revenues would increase by about \$1 billion—including \$500 million for schools.

Given (1) the wide range of services provided by cities, counties, and schools and (2) recent election experience in which taxes were not imposed because they did not receive approval by two-thirds of the voters, we expect this measure would result in major increases in local taxes and spending over time, probably exceeding \$1 billion annually.

***More Stable Local Revenues.*** Given the number and magnitude of past state actions affecting local tax revenues and resources, this measure's restrictions on state authority to enact such measures in the future would have potentially major beneficial fiscal effects on noneducation local governments. For example, the state could not enact measures that require redevelopment agencies to pass through more revenues to schools. Similarly, the state could not borrow or redirect gasoline sales tax revenues as part of a state budget solution. In these cases, this measure would result in noneducation local government resources being more stable—and higher—than otherwise would be the case. The magnitude of increased local resources associated with these provisions is unknown and would depend on future actions by the state. Given past actions by the state, however, this increase in local resources could be billions of dollars in some years. These increased local resources could result in higher spending on local programs or decreased local fees or taxes.

### **Lower Resources for State Programs**

Under the measure, the state could not: (1) use redevelopment or other local funds to support education or (2) borrow or redirect property tax or gasoline sales tax revenues as part of a state budget solution. As a result, the state would need to take alternative actions to balance the state budget in some years—such as increasing taxes or decreasing spending on state programs. Given current and previous actions by the state, we esti-

mate that this decrease in state fiscal authority could reduce state resources by billions of dollars in some future years.

### **Summary of Fiscal Effects**

The measure would have the following major fiscal effects:

- Major increases—probably over \$1 billion—in annual city, county, and school revenues and spending, depending on local voter approval of future tax proposals.
- Significant constraints on state authority over city, county, special district, and redevelopment agency funds. As a result, higher and more stable local government resources, potentially affecting billions of dollars in some years. Commensurate reductions in state resources, resulting in major decreases in state spending and/or increases in state revenues.

Sincerely,

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Mac Taylor  
Legislative Analyst

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Michael C. Genest  
Director of Finance