

TAX RELIEF AND LOCAL GOVERNMENT

The primary focus of state and local government is to provide basic services, such as public safety, education, a safety net of health care and human services, transportation, safe water and other public infrastructure. These services provide the foundation that enables private businesses and families to flourish.

STATE SUPPORT FOR LOCAL ECONOMIC DEVELOPMENT

For states, economic development activities have two primary motivations. One is to help provide the platform for sustained statewide economic growth. The second is to assist local communities, particularly those that may have been disadvantaged in some way, to overcome blight conditions and provide enhanced growth of business opportunities in designated areas. Both types of efforts can help provide private income as well as enhance tax collections under existing rates.

States are more constrained than nations in what they can do to stimulate economic development. California's Constitution forbids the state from adopting budgets that plan for deficits. Thus, the state cannot provide stimulus by borrowing as the federal government does. States must balance assistance to private business against all of the other priorities, including provision of basic services.

States can provide certain incentives to business activities that are intended to provide more statewide growth, either through direct expenditures (e.g. stem cell research) or through the structure of the tax system, (e.g. "tax expenditures" such as the

TAX RELIEF AND LOCAL GOVERNMENT

research and development tax credit). Providing a differential in treatment for these types of activities may provide both public and private dividends in future years because these activities have more potential to provide rapid economic growth than other business investment.

At the local level, land use regulation is key to the long-term economic growth of communities. While the state sets a legal framework, local government entities are responsible for implementing it. California is a vast state with many variations in conditions. Inherently, some geographical areas have advantages for certain land uses that others do not, and existing land uses often will help make related uses successful.

Given the state's significant ongoing budget problem, it is necessary to examine state funding for all programs. The Budget proposes a different method for local government to engage in local economic development activities, eliminates state tax benefits for Enterprise Zones, and proposes major changes in the way local redevelopment is funded and operated. See the Revenue Estimates chapter for a more detailed discussion of the Budget's Enterprise Zone proposal.

REDEVELOPMENT

Proposition 13 reduced local property tax revenues by 57 percent. After the passage of Proposition 13, the state shifted costs to itself and later provided new revenues to local government to partially replace this revenue loss. About 37 percent of property tax revenues currently funds K-14 school obligations under Proposition 98, offsetting what would otherwise be state General Fund costs. The balance of property taxes are distributed as follows: cities receive 18 percent, counties almost 25 percent, special districts 8 percent, and redevelopment agencies 12 percent. The receipts of individual local entities may vary greatly from these statewide percentages depending on what their shares of property tax were when property tax was reallocated following the adoption of Proposition 13.

The expansion of redevelopment agencies has gradually shifted property tax away from schools, counties, special districts, and city general purposes. Redevelopment agencies receive most of the growth in property tax revenue from within their boundaries, including the growth that would otherwise be allocated to agencies providing services in the redevelopment area—such as schools—that do not have a role in creating or governing them. Some of the growth revenue is “passed through” to the jurisdictions

that provide services through locally negotiated agreements and under state law in certain circumstances.

Redevelopment is designed to eliminate blight. The California Community Redevelopment Law (CRL), which was first enacted in 1945 and substantially expanded in 1951, allows cities and counties to establish redevelopment agencies (RDAs) to address blight. Originally, the main tool of redevelopment was the use of eminent domain to acquire private properties, demolish dilapidated and unusable structures, clean up the land, and consolidate small parcels and then make the larger property available for development. The CRL prescribes a complex process for RDA establishment consisting of findings of blight pursuant to statutory definitions, public notifications, and public hearings. RDAs are established by a vote of the governing body of the sponsor agency. These ordinances are potentially subject to referendum votes of sponsor agency voters but are not subject to any approval by governing bodies or voters of jurisdictions that share the same territory. RDAs have statutory limits on the number of years they can create debt and for the total lifetime of the project. Relieving blight is intended to be accomplished in a limited time. RDAs were not intended to become a permanent source of business subsidies.

In 1952, voters approved a constitutional amendment to allow tax increment to fund redevelopment projects and to be pledged for repayment of bonds. The ballot analysis and arguments implied that the expense of redevelopment would otherwise come from the general funds of the sponsor agency and that "this constitutional amendment makes it possible for the entire amount advanced out of public funds to be reimbursed out of taxes on the increased valuation of the property after improvement. In other words, the property will carry itself, and the expenses will be paid out over a term of years." This implied the tax increment was solely the amount of increase in value caused by the redevelopment of specific properties.

Over time, most of the increase in value of all of the properties in the redevelopment area has been generally the result of inflation in the economy and of property values. This increase in value is tax increment that goes to the redevelopment agency. There is no growth in assessed value for the county, school districts, community college districts, or special districts that also serve the redevelopment territory. Over the 40 or more years of life for a typical RDA, this shift of revenue can dwarf base property tax revenue.

In 1998, the Public Policy Institute of California (PPIC) published "Subsidizing Redevelopment in California", one of the few independent studies to examine the

TAX RELIEF AND LOCAL GOVERNMENT

fiscal impact of redevelopment. The PPIC found that "...fewer than one-quarter of the (redevelopment) projects came close to being responsible for the property taxes they received. These projects were also the ones with the most vacant land."

Redevelopment agencies are supposed to help build affordable housing.

RDAs are required to devote 20 percent of their income to building low-income housing. Many RDAs have large balances in their housing funds and have not developed housing. Despite efforts to provide for the expenditure of these funds for housing, large balances persist.

Most development in RDAs is shifted from elsewhere in the state. The private development that occurs in redevelopment project areas often would have occurred even if the RDAs were never established. There is little evidence that redevelopment projects attract business to the state. Studies indicate most of the business development is simply shifted from elsewhere in the state. While this may help relieve localized blight and equalize economic activity relative to nearby communities, there are better alternatives for local entities to fund these efforts without shifting resources from schools, counties, special districts, and core city services.

This revenue could be funding basic public safety services and augment school funding. Cities, counties, special districts, and K-14 schools are losing billions of dollars in property tax revenues each year to subsidize redevelopment. The Department of Finance estimates that under current law, RDAs will divert \$5 billion in property tax revenue from other taxing agencies in 2011-12. Of this amount, \$1.1 billion is passed through to the agencies providing services in the area. This reduces funding needed for law enforcement, fire protection, road maintenance, parks, libraries, and other local services. Furthermore, the state General Fund must backfill the property tax revenues diverted from K-14 schools, at a cost of approximately \$1.8 billion dollars per year.

Economic growth is not likely to rescue basic local services. Law enforcement, fire protection, emergency response, and other services funded from local general revenues have been reduced substantially and face the potential of deeper reductions in the near future. While property tax revenues are expected to stabilize and stop declining by next year, sales tax revenues and property tax revenues will not recover to pre-recession levels for many years. Inflation is likely to be low for some time. However, cost pressures will remain. Economically driven growth in sales tax and property tax is

unlikely to provide much real spending power improvement for local government in the foreseeable future.

The Budget proposes a new approach to fund economic development activities at the local level and phases out the current funding mechanism for redevelopment agencies. This proposal will return billions in property tax revenues to schools, cities, and counties. These funds will help sustain core functions including law enforcement, fire protection, and education. Below is a summary of the proposal:

- **Change redevelopment funding: Provide improved options to fund local economic development with voter approval.** The Budget proposes a new financing mechanism for economic development. Specifically, the Budget proposes that the Constitution be amended to provide for 55-percent voter approval for limited tax increases and bonding against local revenues for development projects such as are currently done by RDAs. Voters in each affected jurisdiction must approve use of their tax revenues for these purposes.
- **Shift existing redevelopment taxes to core local services.** The Budget prohibits existing agencies from creating new contracts or obligations effective upon enactment of urgency legislation. By July 1, existing agencies would be disestablished and successor local agencies would be required to use the property tax that RDAs would otherwise have received to retire RDA debts and contractual obligations in accordance with existing payment schedules. This is estimated to cost \$2.2 billion in 2011-12. Finance estimates \$3 billion will remain after these debt service and contractual payments. From this remaining amount, one-time payments estimated at \$1.1 billion will be provided equal to the pass-through payments that otherwise would be received. Of the remaining \$1.9 billion the Governor's Budget directs \$1.7 billion on a one-time basis to offset state General Fund costs for Medi-Cal (\$840 million) and trial courts (\$860 million). The final \$210 million will be distributed on a one-time basis to cities, counties, and special districts proportionate to their current share of the countywide property tax.
- **Provide revenues for core local services.** Beginning in 2012-13, the amounts remaining after payment of pre-existing RDA debts and contractual obligations will be distributed to cities, counties, non-enterprise special districts, and K-14 schools in amounts proportionate to their share of the base countywide property tax. The only exception is that roughly \$50 million that would otherwise be distributed to enterprise special districts (mainly water and waste disposal districts) will instead be provided to counties. Enterprise special districts are mainly fee-supported.

TAX RELIEF AND LOCAL GOVERNMENT

In 2012-13, this is expected to result in an increase in annual local revenues (over the amounts they would have received in pass-throughs) of approximately \$1.0 billion for schools, \$290 million for counties, \$490 million for cities, and \$100 million for non-enterprise special districts. Funds received by K-14 schools would not count toward the Proposition 98 guarantee. These monies would augment existing funding, and could be used at the discretion of school and community college districts. The sums received by schools would be distributed to both school districts and community college districts throughout the county, primarily based on numbers of students.

- **Use housing balances for housing.** Amounts in the RDA's balances reserved for low-moderate income housing would be shifted to local housing authorities for low and moderate income housing.
- **Funding for core local services increases as debts are paid off.** After 2011-12, the money available after payment of RDA debt would be distributed to schools, counties, cities, and non-enterprise special districts for general uses. These distributions will generally reflect the distribution of property tax in each county under existing law. This will help counties to absorb costs and provide enhanced services associated with realigned programs, if they choose to use the money in that way. Successor entities would continue the process of retiring RDA debt, which is expected to take at least 20 years. As the RDA debt is retired, the monies formerly used for debt service payments will flow to local governments.

TAX RELIEF

The funding that the state expends for tax relief has been reduced significantly in the past several budgets. Funding for property tax relief loans and grants for seniors and persons with disabilities has been eliminated. The only remaining tax relief programs with funding in the 2010-11 Budget are the exemption from property tax for the first \$7,000 value of principal residences, which is required by the California Constitution, and the Williamson Act property tax reduction for agriculture and open space.

WILLIAMSON ACT OPEN SPACE SUBVENTIONS

Under the Williamson Act, property owners enter into voluntary contractual agreements with counties to reserve their land for agricultural or open-space purposes, in exchange for which the county assesses their land at a lower value for property tax purposes.

TAX RELIEF AND LOCAL GOVERNMENT

Williamson Act contracts are generally for a 10-year period, although some can also be for 20 years. After the first year, the contracts annually renew for an additional year, unless notice of non-renewal is given by the county or by the property owner. If such notice is given, the assessed value of the property under a 10-year contract increases by specified percentages over a nine-year period. In the tenth year the land is again assessed at full value. The same principle applies to 20-year contracts.

Until 2009-10, the Budget Act annually appropriated approximately \$35 million to partially offset the property tax revenues lost by local governments due to these lower assessments. Each participating county received a payment of \$2 per acre of non-prime agricultural land, and \$5 per acre of prime agricultural land.

Funding for these subvention payments was suspended in the 2009 Budget Act due to fiscal constraints. However, Chapter 722, Statutes of 2010 appropriated \$10 million for an alternative form of Williamson Act subvention payments for 2010-11. The bill also made several technical changes to the Williamson Act.

- The Budget eliminates the current-year appropriation for Williamson Act subventions and does not provide ongoing state funding. The program will thus be a local program. Funding provided from the redevelopment agencies tax shift could help counties continue this program on their own.

LOCAL GOVERNMENT EXPENDITURES

State funding for local government and shared programs is mostly included in specific program budgets and is not described in this chapter. For example, state funding for locally delivered mental health programs, social services programs, and health programs is reflected in the budgets for the Departments of Mental Health, Social Services, Public Health, and Health Care Services.

LOCAL LAW ENFORCEMENT GRANTS

The General Government portion of the Budget proposes \$420 million General Fund for various local law enforcement programs, which will be backfilled on a dollar-for-dollar basis with realignment funding. In addition to these funds, the Budget also provides \$57 million General Fund for local grant programs administered through the California Emergency Management Agency and \$29 million General Fund for local grant programs

TAX RELIEF AND LOCAL GOVERNMENT

administered by the Department of Corrections and Rehabilitation. These funds also will be fully backfilled with realignment funding.

The \$420 million in funding in the General Government portion of the Budget will be distributed as follows:

- \$107 million for the Citizens' Option for Public Safety Program – These funds are distributed on a population basis to police and sheriffs' departments, with each department receiving a minimum \$100,000 grant. Funds may be used for discretionary front-line law enforcement purposes such as peace officer salaries and equipment.
- \$107 million for the Juvenile Justice Crime Prevention Act – These funds are distributed to counties on a population basis, and are used for countywide, multi-jurisdictional efforts to both prevent and address the causes of juvenile delinquency.
- \$35 million for Jail Booking Fee Subventions – These funds are provided primarily to sheriffs' departments to offset the cost of booking city arrestees into county jails. This eliminates the need for sheriffs to charge police departments for this activity.
- \$152 million to support juvenile probation efforts at the county level.
- \$19 million for the Small/Rural Sheriffs Program – These funds are provided to 37 sheriffs' departments based on statutory formulas and may be used for discretionary purposes.