Date of Hearing: June 15, 2016

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Susan Talamantes Eggman, Chair
SB 817 (Roth) – As Amended February 22, 2016

SENATE VOTE: 38-0

SUBJECT: Local government finance: property tax revenue allocations: vehicle license fee adjustments.

SUMMARY: Provides a city incorporating after January 1, 2004, and on or before January 1, 2012, with property tax in lieu of vehicle license fees (VLF). Specifically, **this bill**:

1) Establishes a vehicle license adjustment amount for a city incorporating after January 1, 2004, and on or before January 1, 2012, as follows:

   a) A formula to calculate the base year VLF adjustment amount for fiscal year (FY) 2016-17, which uses the population of the incorporating city, times the sum of the most recent VLF adjustment amount for all cities in the county, divided by the sum of the population of all the cities in the county; and,

   b) A formula to calculate the VLF adjustment amount for FY 2017-18, and each FY thereafter, that includes the percentage change from the immediately preceding FY to the current FY in gross taxable assessed valuation (property tax revenues).

2) Provides that, if the Commission on State Mandates determines that this bill contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made, pursuant to current law governing state mandated local costs.

FISCAL EFFECT: According to the Senate Appropriations Committee, there is a one-time, permanent shift of approximately $18 million in property tax revenues in 2016-17 from the Riverside County Educational Revenue Augmentation Fund (ERAF) to four recently-incorporated cities. The General Fund would generally backfill the reductions from ERAF to replace funding that would otherwise go to schools pursuant to Proposition 98 minimum funding guarantees. The initial General Fund backfill payments would increase each year thereafter at the property tax growth rate. Unknown, likely minor state reimbursable costs to Riverside County officials to adjust property tax allocation formulas for the four recently-incorporated cities (General Fund). It is unlikely that counties would file a claim for reimbursement for these minor one-time costs.

COMMENTS:

1) **VLF**. VLF is a tax on the ownership of a registered vehicle in place of taxing vehicles as personal property. Prior to 1935, vehicles in California were subject to property tax, but the Legislature decided to create a statewide system of vehicle taxation. The taxable value of a vehicle is established by the purchase price of the vehicle, depreciated annually according to a statutory schedule. Prior to recent budget actions, the state collected and allocated VLF revenues, minus administrative costs, to cities and counties. The VLF tax rate is currently 0.65% of the value of a vehicle, but historically (from 1948-2004), it was 2%. In 1998, the

Legislature cut the VLF rate from 2% to 0.65 % of a vehicle's value. The state General Fund backfilled the lost revenues to cities and counties with revenues equivalent to the full 2% VLF tax rate.

2) **VLF-Property Tax Swap (2004-05 Budget) and Subsequent Legislation**. Prior to the 2004 budget agreement, the total VLF revenue, including the backfill from the state General Fund, was allocated in proportion to population. As part of the 2004-05 budget agreement, the Legislature enacted the "VLF-property tax swap," which replaced the backfill from the state General Fund with property tax revenues (dollar-for-dollar) that otherwise would have gone to schools through ERAF. This replacement funding is known as the "VLF adjustment amount". The state General Fund then backfilled schools for the lost ERAF money. After the dollar-or-dollar swap in FY 2004-05, property tax in lieu of VLF payments (VLF adjustment amount) to cities and counties is allocated in proportion to each jurisdiction's annual change in gross assessed valuation (property tax revenues).

   The 2004-05 budget agreement did not provide compensating property-tax-in-lieu-of-VLF for future new cities or for annexations to cities where there was pre-existing development. Prior to the 2004-05 budget agreement, a newly incorporated city received additional VLF revenues based on three times the number of registered voters in the city at the time of incorporation. For most cities, this increased allocation continued for the first seven years. Following the 2004-05 budget agreement, no cities received this VLF revenue bump upon incorporation. Cities that had not incorporated by FY 2004-05 receive no property tax in lieu of VLF, and therefore, do not have a VLF adjustment amount.

   The temporary remedy to address the lack of property-tax-in-lieu-of-VLF for annexations and incorporations after the budget agreement on August 5, 2004, came in the form of AB 1602 (Laird), Chapter 556, Statutes of 2006. AB 1602 specified that a city that annexes, or an unincorporated area that incorporates after August 5, 2004, but prior to July 1, 2009, will receive special allocations from a portion of the remaining VLF revenues. The funding formula contained in AB 1602 incorporated an artificially inflated population factor during the first five years for start-up costs, which roughly replicated the broad fiscal incentive for city incorporations that existed before the VLF-property tax swap in 2004. Similarly, for annexations that had pre-existing residential development, AB 1602 increased the per capita VLF allocation, based on each person residing in an annexed area at the time of annexation, in addition to the allocation of VLF revenues, to levels comparable to pre-2004 allocations. AB 1602 expired on July 1, 2009, and gave communities five years to complete annexations or incorporations that were initiated under the assumption that VLF funding would be available. SB 301 (Romero), Chapter 375, Statutes of 2008, eliminated the deadline that communities had to incorporate and eliminated the sunset date for city annexations to receive additional VLF.

   SB 89 (Budget and Fiscal Review Committee), Chapter 35, Statutes of 2011, redirected VLF revenues away from newly incorporated cities, annexations, and diverted funds to the Local Law Enforcement Account to help fund public safety realignment. SB 89 also allocated $25 million to the Department of Motor Vehicles (DMV) in FY 2011-12 for administrative costs and increased the basic vehicle registration fee from $31 to $43.

According to the Senate Appropriations Committee, SB 89 had the effect of eliminating over $15 million in the Motor Vehicle License Fee (MVLFA) revenues in 2011-12 from four newly incorporated cities (Menifee [October 1, 2008], Eastvale [October 1, 2010], Wildomar [July 1, 2008], and Jurupa Valley [July 1, 2011]), as well as over $4 million from cities that have annexed inhabited areas. By abruptly cutting the allocation of VLF funds to newly incorporated cities and for inhabited city annexations, the realignment shift in 2011 disproportionally endangered the fiscal viability of communities that rely on VLF revenues. For example, the City of Jurupa Valley, which incorporated within days of the passage of SB 89, anticipated VLF revenues representing 47% of its General Fund budget.

3) **Bill Summary**. This bill establishes a base year VLF adjustment amount for FY 2016-17 for cities that incorporated after January 1, 2004, and on or before January 1, 2012, to replicate funds that existed for new cities prior to 2004. In each subsequent FY, the VLF adjustment amount would be the city's annual change in assessed property values, which is the same formula used to calculate the VLF adjustment amount for other cities. This bill will only impact four cities: Jurupa Valley, Eastvale, Menifee, and Wildomar, which all incorporated during the timeframe contained in the bill. This bill does not provide a VLF adjustment amount for cities incorporating after January 1, 2012. This bill is author-sponsored.

4) **Author's Statement**. According to the author, " In 2011, one of the steps the Legislature took to close the state's massive budget gap was to pass Senate Bill 89 which eliminated VLF revenue allocated to newly incorporated cities. As a result, four newly incorporated cities in Riverside County – Eastvale, Jurupa Valley, Menifee and Wildomar – lost critical funding.

   "The situation for the City of Jurupa Valley is especially urgent, as VLF funding was eliminated only days before the city incorporated. The residents had voted for cityhood based on state VLF money being available for the new city. Jurupa Valley considered disincorporation, potentially forcing Riverside County to provide essential services to residents which the County has not budgeted for.

   "While ongoing funding is critical to stabilize new cities, VLF revenue is no longer available as a funding source for cities due to the passage of Proposition 30 (2012), which requires that VLF funds be used exclusively for criminal justice realignment. Cities play a vital role in fulfilling many of the state's policy goals which include achieving smart growth objectives, promoting transportation and infrastructure investments, meeting affordable housing needs, and realizing greenhouse gas reduction goals.

   "SB 817 utilizes a county's ERAF. If the funds are fully used, the school share of ERAF will be used to make up the difference. This will be fully reimbursed by the state's general fund so there is no impact on schools."

5) **Previous Legislative Attempts to Address the Impacts of SB 89.** SB 1566 (Negrete McLeod) of 2012 and AB 1098 (Carter) of 2012 sought to remedy the loss of ongoing revenues to new cities and annexations after the 2004 VLF property tax swap, a fix that was achieved by AB 1602. SB 89 did not remove the formulas to calculate the VLF revenue to incorporated or annexed cities in statute. SB 1566 and AB 1098 would have restored the funding allocations in AB 1602. SB 1566 was held on the Senate Appropriations Committee's suspense file, and AB 1098 was vetoed by the Governor.

SB 56 (Roth) of 2013 was returned to the Secretary of Senate without further action, pursuant to Joint Rule 56. AB 677 (Fox) of 2013 was filed with the Chief Clerk without further action, pursuant to Joint Rule 56. SB 56 would have established VLF adjustment amounts for annexations, and also included a formula for cities that incorporated after 2004 to receive a VLF adjustment amount similar to the formulas established in this bill.

AB 1521 (Fox) of 2014, vetoed by the Governor, and AB 448 (Brown) of 2015, held on the Senate Appropriations Committee's suspense file, would have modified the amount of VLF allocated to counties and cities to include changes in the assessed valuation within annexed areas.

SB 69 (Roth) of 2014 and SB 25 (Roth) of 2015, which were vetoed by the Governor, would have provided a city incorporating after January 1, 2004, and on or before January 1, 2012, with property tax in lieu of VLF, and are nearly identical to the provisions in this bill. AB 2277 (Melendez), held on this year's Assembly Appropriations Committee's suspense file, would have changed the formulas for calculating the VLF adjustment amounts for the four cities identical to the provisions contained in this bill.

6) **Conflicting Legislation**. Provisions of this bill conflict with AB 448 (Brown), pending in the Senate, and may need amendments to address the conflict, should the bills continue to move through the legislative process.

7) **Budget Appropriation.** Last year, the State Budget contained a one-time appropriation to address the General Fund shortfalls of the four newly incorporated cities in Riverside County; however, the appropriation does not address ongoing funding needs. SB 107 (Committee on Budget and Fiscal Review), Chapter 325, Statutes of 2015, appropriated nearly $24 million from the General Fund to the Department of Forestry and Fire Protection in order to forgive monies owed by the newly incorporated cities for services rendered by the County of Riverside. The fiscal relief authorized by SB 107 has been used to forgive more than $1 million in debt owed by the City of Menifee, $1 million in debt owed by the City of Wildomar, and $21 million in debt owed by the City of Jurupa Valley for services that Riverside County provided to those cities following their incorporation. The City of Eastvale received no money following the passage of SB 107 and unsuccessfully sought to challenge the County's decision in the courts to allocate the fiscal relief to the other three newly formed cities.

8) **Policy Consideration.** The Committee may wish to ask the author about the status of conversations with the Governor in light of the budget appropriation contained in SB 107 and past veto messages for nearly identical bills that have expressed concerns with long-term costs to the General Fund.

9) **Arguments in Support**. Supporters argue that this bill reinstates a critical funding component to cities incorporated between January 1, 2004, and January 1, 2012, and ensures their continued viability.

10) **Arguments in Opposition**. None on file.

REGISTERED SUPPORT / OPPOSITION:

Support

Alameda Local Agency Formation Commission
California Association of Local Agency Formation Commissions
California Police Chiefs Association
California State Association of Counties
Cities of Eastvale, Jurupa Valley, Menifee, Murrieta, Riverside, and Wildomar
Contra Costa Local Agency Formation Commission
League of California Citites
Urban Counties of California
Riverside County
Riverside County Division of the League of California Cities
Riverside Local Agency Formation Commission
Riverside Sheriffs' Association
San Mateo Local Agency Formation Commission
Solano Local Agency Formation Commission
Southwest California Legislative Council
Yolo Local Agency Formation Commission

Opposition

None on file

Analysis Prepared by: Misa Lennox / L. GOV. / (916) 319-3958