

Date of Hearing: May 12, 2020

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Cecilia Aguiar-Curry, Chair

AB 2040 (Bigelow) – As Introduced February 3, 2020

SUBJECT: Property tax: revenue allocations: County of Madera.

SUMMARY: Requires the Auditor of the County of Madera to reallocate \$4,627,723 from the County's Educational Revenue Augmentation Fund (ERAF). Specifically, **this bill:**

- 1) Requires the county auditor of the County of Madera to make an allocation adjustment for the 2005-06 through 2013-14 fiscal years in the full amount of \$5,856,457 identified in the State Controller Office's (SCO) September 2015 audit of the County of Madera for the 2005-06 through 2013-14 fiscal years, less the amount of \$1,228,734, previously allocated, as specified.
- 2) Provides that the reallocation and transfer of \$4,627,723 shall be made from the County ERAF, as specified.
- 3) Contains a declaration and finding to support its purposes.
- 4) Specifies that if the Commission on State Mandates determines that this act contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made.

FISCAL EFFECT: This bill is keyed fiscal and contains a state-mandated local program.

COMMENTS:

- 1) **Bill Summary and Author's Statement.** This bill requires the Auditor of the County of Madera to reallocate an amount of \$4,627,723 from the County's ERAF to correct errors made by the County in the years 2005-06 through 2013-14. This bill is sponsored by the author.

According to the author, "Rural counties are often impacted by smaller budgets, providing them the need to use their resources wisely. Unfortunately, due to a complicated situation, a county in my district lost a tremendous amount of revenue to the state of California. I am hopeful I can help assist my constituents in returning these dollars back to them."

- 2) **Property Tax.** Article XIII of the California Constitution provides that all property is taxable at the same percentage of fair market value unless explicitly exempted by the Constitution or federal law. The Constitution limits the maximum amount of any ad valorem tax on real property at 1% of full cash value, and directs assessors to only reappraise property when newly constructed, or ownership changes (Proposition 13, 1978). Proposition 13 additionally limits any inflationary growth of the full cash value base to 2% per year.
- 3) **Educational Revenue Augmentation Funds.** Proposition 13 gave the state authority to allocate the local property tax among local agencies, schools, and community college districts. Each year, the state estimates how much each district will receive in local property

tax revenue (and student fee revenue in the case of community colleges). Then, the annual Budget Act appropriates state General Fund to “make up the difference” and fund the district’s revenue limit or apportionment at the intended level based on Proposition 98 (1988), which obligates the state to ensure that school districts all receive a minimum guaranteed level of funding. Frequently, however, the actual property tax revenues allocated to school districts may be less than the state and local agencies anticipate. The state’s education finance system addresses these shortfalls differently for different types of educational entities. For K-12 districts that require additional funding to meet the minimum guaranteed level of funding, known as nonbasic aid school districts, all funding shortfalls are backfilled automatically with additional state aid. In contrast, basic aid districts do not require state aid to meet the minimum guaranteed level of funding because local property tax is sufficient. Explicit state action is required to backfill community college funding shortfalls.

In 1992-93 and 1993-94, in response to serious budgetary shortfalls, the state permanently redirected almost one-fifth of total statewide property tax revenue from cities, counties, and special districts to K-12 and community college districts. Under the changes in property tax allocation laws, county auditors deposit the redirected property tax revenue into a countywide fund for schools, also known as a county’s ERAF.

In 2017-18, cities, counties, and special districts deposited around \$9.6 billion into county ERAFs. These ERAF contributions reduce the state’s funding obligations for K-14 education. Before counties distribute property tax revenue from ERAF to nonbasic aid schools and community colleges, the county diverts some ERAF back to local agencies to account for the Vehicle License Fee (VLF) swap.

- 4) **VLF Swap.** In lieu of a property tax on motor vehicles, the state collects an annual VLF and allocates the revenues, minus administrative costs, to cities and counties. In 1998, the Legislature cut the VLF rate from 2% to 0.65% of a vehicle's value and backfilled the lost VLF revenues to cities and counties from the state’s General Fund. Traditionally, VLF had been allocated on a per-capita basis, meaning new cities that incorporated, or existing cities that annexed inhabited areas, would receive larger shares of the VLF. Revenues serve various purposes including funding local agencies’ core services.

As part of the 2004-05 budget agreement, the Legislature enacted the "VLF-property tax swap," which replaced the VLF 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 VLF swap was a negotiated agreement between the state and cities and counties to replace a state-controlled reimbursement subject to annual appropriation with a locally administered revenue source resulting in a more reliable fund source for these local agencies. Specifically, the VLF swap replaced the General Fund VLF backfill with property taxes redirected at the county level from ERAF and, if ERAF revenues are not sufficient, from nonbasic aid K-12 and community college districts, with all reductions in revenue to K-12 and community college districts offset by additional state aid. The VLF swap continues to shift billions of dollars annually from ERAF to non-school local agencies.

- 5) **SCO Audits.** The SCO is currently required to audit the apportionment and allocation by counties of property tax revenue in accordance with the following schedule:
- a) For counties with a population in excess of 5,000,000, the audit shall be performed annually;
 - b) For counties with a population greater than 200,000 and less than 5,000,000, the audit shall be performed on a three-year cycle; and,
 - c) For counties with a population of 200,000 or less, the audit shall be performed on a five-year cycle.

According to the SCO's July 1, 2005 through June 30, 2014 audit of Madera County, "The county used incorrect prior year assessed values when calculating the VLF swap growth in FY 2006/07, causing the VLF swap to be misallocated for FY 2006-07 forward in the amount of \$5,856,457." The SCO recommended the County, "Should recalculate the VLF amounts, beginning in FY 2006-07, and correct the misallocated amounts. The County should use the corrected calculations going forward."

- 6) **Madera County.** According to Madera County, "In February 2006, the County's Assistant Auditor Controller died unexpectedly. The Assistant had been responsible for property tax apportionment in the County of Madera for 12 years and was the only person in the Auditor-Controller's Office who understood the very complex apportionment process. In the same fiscal year, 2005-06, a new regime for substituting property taxes for VLF revenues (the so-called swap) that were no longer available to counties and cities was implemented throughout the State...The Auditor-Controller's staff prepared the VLF schedule for fiscal year 2006-07 to factor up the prior year VLF amounts for the County and the two cities based on assessed values for 2005-06. At some point in the apportionment process, staff inadvertently introduced erroneous numbers that overstated the 2005-06 assessed values, resulting in an under-apportionment of property taxes in-lieu of VLF to the County and cities in 2006-07.

"The error in 2006-07 was relatively small, at about \$300,000; because the VLF revenue grows in proportion of growth of assessed value of property in the County and the increase is cumulative from year to year, the error increased yearly thereafter. By 2013-14, the final year of the State Controller's audit of Madera County's property tax apportionments, the total error amounted to \$5.8 million. Thus, the error shorted the County and the two cities a combined \$5.8 million over the period of 2006-07 through 2013-2014.

"The Auditor-Controller's staff committed the error. However, there are circumstances beyond the County's control and arbitrarily imposed by the State Controller that limit the County's recovery from the error to \$1.2 million; that limitation nets to the aforementioned loss of \$4,627,723, of which approximately \$3.2 million is the County's loss and the remainder is the two cities loss."

- 7) **Arguments in Support.** According to the Rural County Representatives of California, "Regrettably, the State Controller's audit was delayed by a number of years, resulting in a larger fiscal impact than would have occurred had the audit been completed in a timely manner. While current law only allows the County to recoup a portion of the lost revenue, AB 2040 requires the Madera County auditor-controller to make an allocation adjustment for

the fiscal years 2006-07 through 2013-14, acknowledging that the delayed audit is partly to blame for the significant revenue loss.”

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

REGISTERED SUPPORT / OPPOSITION:

Support

County of Madera
Rural County Representatives of California

Opposition

None on file

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