Date of Hearing: April 11, 2018

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Cecilia Aguiar-Curry, Chair
AB 2268 (Reyes) – As Amended April 2, 2018

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

SUMMARY: Modifies the formulas for calculating annual vehicle license fee (VLF) adjustment amounts to include the assessed property valuation within inhabited territory annexed to cities. Specifically, **this bill**:

1) Provides that the VLF adjustment amount formula in existing law, which excludes the assessed property valuation in an area upon annexation, for the fiscal year (FY) 2006-07 and thereafter, applies until FY 2017-18.

2) Establishes a formula to calculate the VLF adjustment amount for FY 2018-19, that includes the percentage change from FY 2017-18 to FY 2018-19, in the assessed property valuation within the jurisdiction, which includes the assessed property valuation of annexed territory.

3) Establishes a formula to calculate the VLF adjustment amount for FY 2019-20 and each FY thereafter that includes the percentage change from the immediately preceding FY to the current FY in assessed property valuation.

4) 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: This bill is keyed fiscal and contains a state-mandated local program.

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-for-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 measure would provide ongoing property tax revenue to approximately 140 cities that had annexed inhabited territory in reliance on previous financial incentives that were removed by the passage of SB 89 in 2011. The bill also provides revenue for future annexations of inhabited territory. The funding formula used in AB 2268 is similar to the formula approved by the Legislature to restore funding to the four most recent incorporated cities in last year's SB 130 (Committee on Budget and Fiscal Review). Additionally, in future years, the amount of revenue will be adjusted according to the same rules applied to other cities.

4) **Author's Statement.** According to the author, "AB 2268 restores revenue for inhabited areas annexed into cities. Given recent policy changes regarding the vehicle license fee, it is critical that we prioritize making cities whole. This bill will ensure that localities have the resources to provide vital services to their residents."

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. These measures 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. Last year, SB 37 (Roth) would have changed the formulas for calculating annual VLF adjustment amounts for four cities that incorporated after 2004 but before 2012. SB 37 was held on the Senate Appropriations Committee suspense file.

   AB 2277 (Melendez) of 2016, held on the Assembly Appropriations Committee's suspense file, would have changed the formulas for calculating the VLF adjustment amounts for the four cities.

6) **Budget Appropriation.** There have been several budget appropriations in the last few years 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.

Last year, SB 130 (Committee on Budget and Fiscal Review), Chapter 9, Statutes of 2017, changed the formulas for calculating annual VLF adjustment amounts for four cities that incorporated after 2004 but before 2012.

7) **Zero-Sum Game.** Allocating property tax revenues is a zero-sum game; every reallocation creates winners and losers. AB 2268 makes a winner out of cities that annex inhabited territory moving forward. The higher VLF adjustment amounts they receive under AB 2268's formula will reduce the amounts of property tax revenues they contribute to ERAF. In some years, the fiscal loser will be the state General Fund, which must backfill the property tax revenues that schools won't get from ERAF. The annual loss to the state General Fund will grow in the future in accordance with property tax revenues.

8) **Technical Amendment.** This bill intends to provide additional property tax revenue to cities that annex inhabited territory. However, clause (I) of subsection (D) cross-references subdivision (c) of Revenue and Taxation Code (RTC) Section 11005, which is specific to city incorporations. The Committee may wish to adopt a technical, conforming amendment by striking the reference to RTC Section 11005(c).

9) **Arguments in Support.** Supporters argue that this bill would restore funding stability to cities that annex inhabited territory, and reestablish a foundation that supports sustainable and compact growth policies.

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

REGISTERED SUPPORT / OPPOSITION:

Support

League of California Cities [SPONSOR]
Cities of Chico, Fontana, and Thousand Oaks
Marin County Council of Mayors and Councilmembers

Opposition

None on file

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