

Date of Hearing: March 27, 2019

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Cecilia Aguiar-Curry, Chair
AB 818 (Cooley and Quirk) – As Introduced February 20, 2019

SUBJECT: Local government finance: vehicle license fee adjustment amounts.

SUMMARY: Provides a city that incorporated after January 1, 2012, with property tax in lieu of vehicle license fees (VLF). Specifically, **this bill:**

- 1) Establishes a VLF adjustment amount for a city incorporating after January 1, 2012, as follows:
 - a) A formula to calculate the base year VLF adjustment amount for the first fiscal year (FY) of incorporation, 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 the second FY of incorporation, 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) Requires that in addition to the VLF adjustment amount provided in the first year of incorporation, for the first five years of incorporation the entity receives the sum of the most recent VLF adjustment amounts for all cities in the county, times the population of the incorporating city, times the result of dividing the difference between the number of registered voters in the city on the effective date of its incorporation multiplied by three and the actual current population of the city, by the current population of the city.
- 3) 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 bill establishes a base year VLF adjustment amount for the first year of incorporations for cities that incorporated after 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 also provides for additional VLF adjustment amount for the first five years following incorporation.

This bill is sponsored by the author.

- 4) **Author's Statement.** According to the author, "For the past eight years, despite the state's population increasing by 2 million residents, no new cities have formed in California. A primary factor for this is the passage of SB 89 in 2011, which removed a financing mechanism communities previously relied on to assist incorporation. Residents who wish to incorporate are motivated by a desire to improve their quality of life and services in their community. A city government can oftentimes be more responsive to local issues. Currently, local community members throughout California are exploring the opportunity to incorporate their community into a new city, but the funding eliminated by SB 89 makes it fiscally unrealistic. In 2017, the Legislature passed SB 130 to help four recently incorporated cities that were harmed by the passage of SB 89. AB 818 proposes that the Legislature provide the same financing solution that was provided in SB 130 for future city incorporations."
- 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. 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.

AB 2491 (Cooley) of 2018, held on the Assembly Appropriations Committee suspense file, is identical to AB 818.

- 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.

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 818 makes a winner out of cities that incorporate in the future. The higher VLF adjustment amounts they receive under AB 818'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 will not get from ERAF. The annual loss to the state General Fund will grow in the future in accordance with property tax revenues.
- 8) **Arguments in Support.** Supporters argue that this bill reinstates a critical funding component to cities that incorporate moving forward and ensures their ability that incorporation is a viable option for communities.
- 9) **Arguments in Opposition.** None on file.

REGISTERED SUPPORT / OPPOSITION:

Support

City of San Luis Obispo
League of California Cities

Opposition

None on file

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