SANDAG
San Diego's Regional Planning Agency

POLICY BOARD AGENDA

Friday, June 13, 2003
10:15 a.m.
SANDAG
401 B Street, 7th Floor Board Room
San Diego, CA 92101

- **PUBLIC COMMENT**
- **STATE-LOCAL GOVERNMENT FISCAL REFORM**

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MISSION STATEMENT

The 18 cities and county government are SANDAG serving as the forum for regional decision-making. SANDAG builds consensus, makes strategic plans, obtains and allocates resources, and provides information on a broad range of topics pertinent to the region's quality of life.

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Welcome to SANDAG! Members of the public may speak to the Board on any item at the time the Board is considering the item. Please complete a Speaker's Slip which is located in the rear of the room and then present the slip to the Clerk of the Board. Also, members of the public are invited to address the Board on any issue under the agenda item entitled Public Comments/Communications. Speakers are limited to three minutes. The SANDAG Board may take action on any item appearing on the agenda.

This agenda and related staff reports can be accessed on SANDAG's Web site at www.sandag.org under Meetings. Public comments regarding the agenda can be forwarded to SANDAG via the e-mail comment form also available on the Web site. E-mail comments should be received no later than noon on the Wednesday preceding the Friday SANDAG Board meeting.

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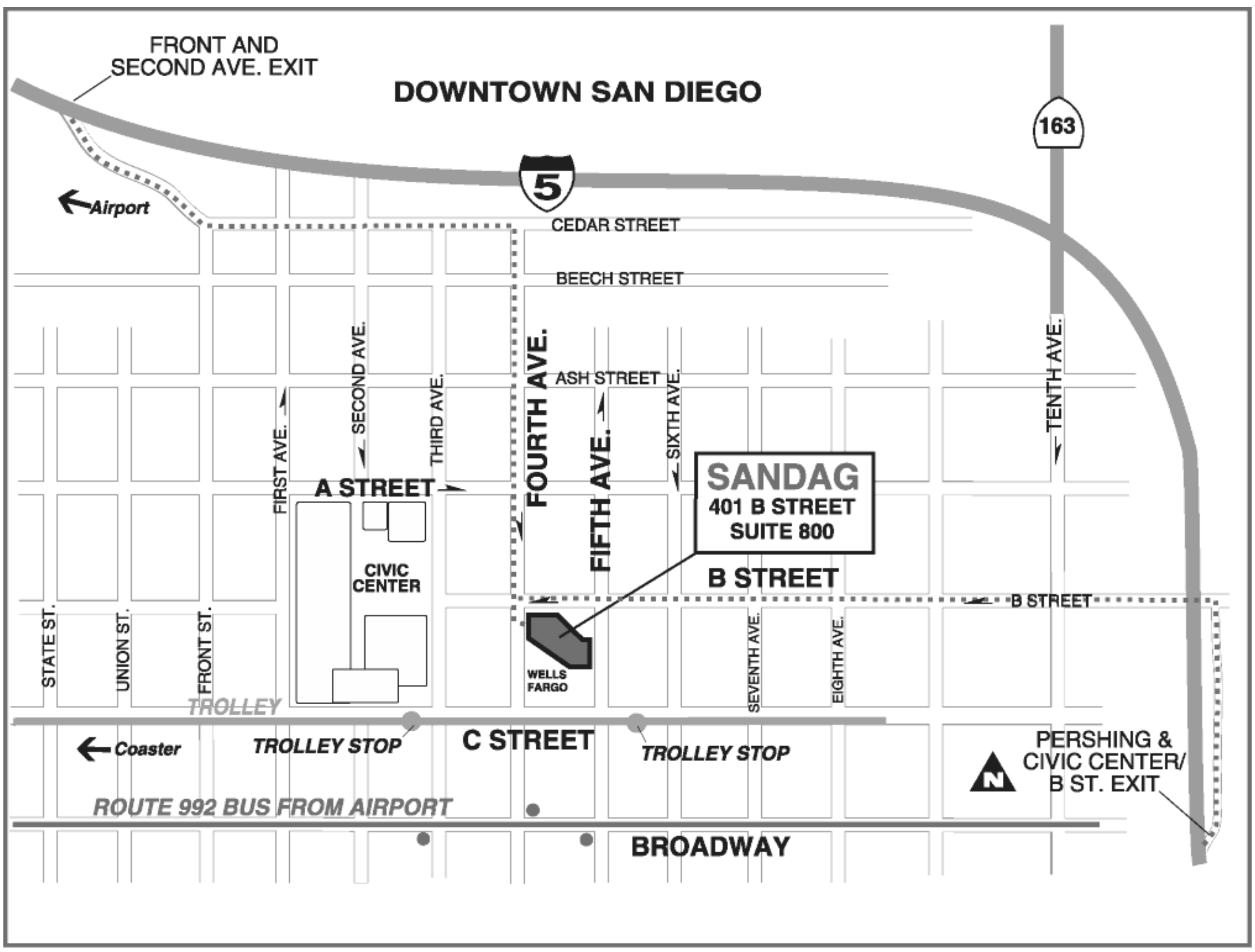

Friday, June 13, 2003

SANDAG POLICY BOARD MEETING

STATE-LOCAL GOVERNMENT FISCAL REFORM

- What do you like about the current SANDAG proposal?
- How can it be improved?
- What next steps should be taken?

Introduction

Over the past several months, SANDAG staff has been working with City Managers, County CAO staff, and their finance officers to develop a regional consensus on a proposal to improve the current state-local government fiscal relationship. This work has included presentations, workshops and individual meetings to determine local goals and objectives as well as local concerns. The initial SANDAG fiscal reform proposal was used as a starting point for these discussions. Copies of the initial SANDAG proposal can be found on the SANDAG web site www.sandag.org; under Programs, click on Economics and Finance, under Publications, click on "Achieving Fiscal Reform In California". Also, a brief summary of this proposal is provided later in this report.

The discussion concerning the state-local government fiscal relationship has been revived primarily because of the state budget deficit and the implications that local government may be asked to assist in closing the budget gap. Representatives from the League of Cities and the California State Association of Counties believe that the state budget "crisis" may provide a unique opportunity to pass legislation that will improve the fiscal relationship between local and state government; accomplished by protecting local government revenues and reducing the impacts from the "fiscalization of land use". Currently, jurisdictions receive approximately 11 times more revenue back from a retail development than residential development on the same size lot. In addition, the amount of property tax revenue jurisdictions receive annually from residential units is insufficient to pay for all the public services required to accommodate the housing unit. Locally, our jurisdictions should be prepared to respond and offer "preferred" alternatives to state initiated fiscal reform proposals. One such proposal, for example, is AB 1221 (Steinberg/Campbell). Copies of this legislation can be obtained on the State Assembly web site www.assembly.ca.gov; click on Legislation and enter "1221" in the box next to Bill Number; the most recent version is June 2, 2003. Also, a brief summary of AB 1221 is provided later in this report.

The purpose of this report is to initiate a discussion on ways to improve the state-local government fiscal relationship. To aid in the discussion during the Policy Development Board Meeting, we have invited City Managers, a representative from the League of Cities, a representative from the California State Association of Counties, and Assemblymember Steinberg, author of AB 1221.

Background

Summary of Comments from CCMA Meetings

Virtually all City/County Managers Association (CCMA) members that attended the May 1, 2003 workshop thought constitutional protection of local revenue sources should be the number one priority. Most felt overcoming the effects of the fiscalization of land use on housing supply is important, but felt the current SANDAG proposal did not go far enough.

Workshop participants requested that the current SANDAG fiscal reform proposal be modified to simulate full mitigation of the retail preference caused by the fiscalization of land use. In addition, workshop participants suggested simulating the effects of removing gas tax revenue from the proposed exchange process, thereby retaining its current mandated use for transportation.

SANDAG staff completed this additional work and presented it to CCMA members on June 5, 2003. After a significant discussion, most Managers in attendance felt that the initial SANDAG proposal was the most acceptable of the alternatives discussed.

As a way of judging the results of each proposal modification, we developed the "Retail Fiscalization Factor". This factor represents how much more revenue a jurisdiction receives from a retail development than from a housing development, of equal lot size. Table 1 shows the results for three reform proposals. In Reform Proposal 1 (SANDAG initial reform proposal), the Retail Fiscalization Factor is reduced from 10.7 to 1.8 by 2030 provided the assessed value of property regionwide grows at an annual rate of 8.3 percent. Property tax revenue growth rates are an important determinant for calculating the Retail Fiscalization Factor. Slower or faster rates of growth in the assessed value of property would result in lower or higher Factors. The three Retail Fiscalization Factors shown under each Reform Proposal represent different property tax growth rates. By modifying the initial SANDAG proposal as shown in Reform Proposal 2, we were able to completely off-set the effects of the fiscalization of land use, reducing the Retail Fiscalization Preference Factor to below one (below one would make housing development more fiscally attractive than retail development).

Summary of the Initial SANDAG Fiscal Reform Proposal

Revenue Protection – Local governments in the San Diego region have expressed that revenue protection is the highest priority. Therefore, any fiscal reform proposal must include a constitutional guarantee that revenues to local government will not be taken away by the state, as has historically occurred, usually during economic downturns.

Revenue Realignment and Creation of Countywide Tax Base – Existing state subventions to local agencies (vehicle license fees, gas taxes, and homeowner's exemption revenue) would be traded to the state for additional property and sales tax revenue (dollar for dollar exchange, no fiscal winners or losers in the base year of the exchange). This even exchange of revenues would be transacted county-by-county, creating a new countywide tax base in each. For each county, the local dollars acquired through the revenue exchange would be deposited in a "Local Revenue Fund" and distributed among cities and the county government in accord with proposed constitutional rules. These rules include a "hold harmless" provision for a base amount of annual revenue, and a population-based rule for distributing the growth in the countywide tax base among cities and a proportional share based rule for distributing the growth in the tax base to the county.

Using the State Sales Tax to Attach More Revenue to Housing – The annual growth in the new countywide tax base would be distributed among cities based on total population. Over time, the new countywide tax base would grow at a rate consistent with the growth in sales tax and property tax. Each year, cities would receive revenue from the new tax base, based on their total population. Receiving revenue on a per capita basis would reduce the need to "chase" retail outlets and sales tax revenue, reducing the effects of the "fiscalization of land use".

Regional Cooperation – Revenue sharing from a countywide tax base would promote regional cooperation in growth management and economic development. Cities, as well as the county government, would receive a financial return based on the performance of local land use decisions and the regional economy. All jurisdictions would benefit to the extent the regional tax base increased as the result of growth in the assessed value of property and taxable sales.

Summary of AB 1221

Under AB 1221 (California Balanced Community Act of 2003), each city and each county would swap, dollar for dollar, a portion of their sales tax revenue for an equal dollar amount of property tax revenue. The situs-allocated sales and use tax rate would be reduced from 1% to 0.5%, and this revenue would be directed to the Educational Revenue and Augmentation Fund (ERAF) in each county. An equal amount of property tax revenue would be shifted from each county ERAF fund to each city and each county.

As the Bill's title indicates, its primary purpose is to improve the balance of service cost and revenues related to land use. AB 1221 would increase municipal revenues from residential, office and industrial land uses. At the same time, AB 1221 reduces (but would not eliminate) the surplus municipal revenue that taxable sales generating land uses contribute in excess of municipal service costs.

The fiscal impacts of AB 1221 on each city and each county depend entirely on how the city or county property tax base and sales tax base will grow in the future. In part, the future growth of these revenue sources depends on the unique character and direction of the local economy. Historical patterns and economic trends suggest that California local governments on the whole would be better off with more property tax and less sales tax. Since 1980, the average annual "real" growth in assessed valuation of taxable property (5.5%) in the state has increase more than twice as fast as taxable sales (2.0%). This trend may not have been the same for each city or county, and past aggregate trends are not necessarily good indicators of future trends for individual cities or counties.

Comparing AB 1221 to the SANDAG Proposal

The SANDAG state-local fiscal reform proposal does not affect the current allocation (in-situs) or the current sales and use tax rate (1%).

The SANDAG proposal exchanges three state subvention revenues (vehicle license fees, gas taxes, and homeowner's exemptions) for more property and sales tax revenues. The trade is dollar for dollar, with no fiscal winners or losers in the exchange year.

Following the exchange, the SANDAG proposal recommends constitutional protection for all local government revenues.

Each year following the exchange year, according to the SANDAG proposal, each city and the county would receive the amount they received in the prior year from the swap plus a share of a new countywide tax base that is attributable to the growth in taxable sales and the assessed value of property countywide. Each year the county would receive a straight proportion, based on the county's proportion of the exchanged revenues in the base year; the remaining funds would be distributed to cities on a per capita basis.

The amount of revenue available to off-set the fiscalization of land use impacts is significantly larger under the SANDAG proposal.

Attachment

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Table 1: Alternative Fiscal Reform Proposals

Current Effects of Fiscalization of Land Use:
Revenue Comparison: 5,000 sq. ft. lot as single family home or retail

	Residential	Retail	Retail Fiscalization Factor
	2,200 sq. ft.	*1,500 sq. ft.*	
Property Value	$350,000	$300,000	
Annual Taxable Sales	$0	$450,000	
City Revenue:			
Property Tax (13% of 1% collected)	$455	$390	
Sales Tax (1%)	-	$4,500	
TOTAL REVENUE	**$455**	**$4,890**	**10.7**

Reform Proposal 1:
SANDAG Initial Proposal - 2030

Retail Fiscalization Factor	Property Tax Growth Rate	Per Capita Revenue	Additional Revenue per Unit	Total Revenue per Unit	Retail Revenue
1.8	8.3%	$847.98	$2,290	$2,745	$4,890
2.9	6.3%	$455.71	$1,230	$1,685	$4,890
4.7	4.3%	$215.06	$581	$1,036	$4,890

Reform Proposal 2:
SANDAG Proposal Plus Transfer 1/2 Cent of Existing 1 Cent - 2030

Retail Fiscalization Factor	Property Tax Growth Rate	Per Capita Revenue	Additional Revenue per Unit	Total Revenue per Unit	Retail Revenue
0.7	8.3%	$1,057.43	$2,855	$3,310	$2,445
1.2	6.3%	$613.94	$1,658	$2,113	$2,445
1.8	4.3%	$341.87	$923	$1,378	$2,445

Reform Proposal 3:
SANDAG Proposal Less Gas Tax Revenue - 2030

Retail Fiscalization Factor	Property Tax Growth Rate	Per Capita Revenue	Additional Revenue per Unit	Total Revenue per Unit	Retail Revenue
1.9	8.3%	$762.20	$2,058	$2,513	$4,890
3.1	6.3%	$408.23	$1,102	$1,557	$4,890
5.0	4.3%	$191.09	$516	$971	$4,890