The Current Recovery is Already Two Years Longer Than Average

- Current (Jul'09)
- Average
- Dec 2001
- Apr 1991
- Dec 1982
- Aug 1980
- Apr 1975
- Dec 1970
- Mar 1961
- May 1958
- Jul 1954

Number of Months
Source: Governor’s May Revision 2016 Fig INT-03
State of the State

Prop30 Sales tax ends 12/31/2016
But state sales tax revenues will hold steady

Operating Budget Debt progress
But large unfunded employee retirement costs remain

Unmet needs: transportation, other infrastructure, draught / water, Cap-and-Trade, poverty, housing, etc.

The Clean-up Era
**Proposition 2* Provisions**

**Debt/Reserve Estimates**

*June Budget Act.* Estimate the following:

- 1.5% of General Fund revenues.
- Capital gains revenues over 8% of General Fund taxes.
- Less amounts that must be spent on Proposition 98.

Choose among the following:

- Pay down certain "wall of debt" items.
- Make extra pension/retiree health payments.

**Debt Payments**

**Budget Stabilization Account**

Fills rainy-day reserve to 10% of General Fund taxes.

---

**Debts and Liabilities Eligible for Accelerated Payments Under Prop2**

<table>
<thead>
<tr>
<th>Dollars in Millions</th>
<th>Outstanding Amount Start of 2016-17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budgetary Borrowing</strong></td>
<td></td>
</tr>
<tr>
<td>Repay Loans from Special Funds</td>
<td>$1,806</td>
</tr>
<tr>
<td>Settle-up Underfunding of Prop98</td>
<td>$1,232</td>
</tr>
<tr>
<td>Repay Transportation Loans</td>
<td>$879</td>
</tr>
<tr>
<td><strong>State Retirement Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>State Retiree Health</td>
<td>$71,773</td>
</tr>
<tr>
<td>State Employee Pensions</td>
<td>$43,291</td>
</tr>
<tr>
<td>Teacher Pensions</td>
<td>$72,718</td>
</tr>
<tr>
<td>Judges Pensions</td>
<td>$3,358</td>
</tr>
<tr>
<td>Deferred Payments to CalPERS</td>
<td>$570</td>
</tr>
<tr>
<td><strong>University of California Retirement Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>UC Employee Pensions</td>
<td>$10,786</td>
</tr>
<tr>
<td>UC Retiree Health</td>
<td>$17,270</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$223,683</strong></td>
</tr>
</tbody>
</table>

Source: Governor's Budget Summary 2016 Fig INT-02
Proposition 30 Temporary Revenues

Will There be a Revenue Cliff?

California’s Big Three Revenues

Personal Income Taxes, Sales Taxes, Corporate Taxes

Prop 30 Temporary
California Ballot Measures November ‘16

✓ **Prop 51 School Bond** $9 Billion. NO POSITION
✓ Prop 52 State Fees on Hospitals. Federal Medi-Cal Matching Funds.
✓ **Prop 53 Statewide voter approval for revenue bonds.**
✓ **Prop 54 Legislature Transparency.** 72 hour print rule
✓ **Prop 55 Personal income tax** - extends increases by 12yrs
✓ **Prop 56 Cigarette Tax** Increase. $2/pack, to fund healthcare, etc.
✓ Prop 57 Allows parole for nonviolent felons. NO POSITION
✓ **Prop 62 Repeal death penalty.**
✓ **Prop 63 Prohibit large-capacity ammo magazines.** NO POSITION
✓ **Prop 64 Legalizes marijuana and hemp.** NO POSITION
  ▪ 15% state excise tax on marijuana sales; establishes packaging, labeling, marketing rules
✓ **Prop 65 Redirect plastic bag revenues.** OPPOSE
✓ Prop 66 Death Penalty Procedures (Expedite).
✓ **Prop 67 Retain Ban on Single-Use Plastic Bags.** SUPPORT

Local Taxes and Bonds in California November 2016

Michael Coleman
Local Revenue Measures November ‘16

✓ 650 local measures
✓ 427 taxes and bonds

✓ 184 school bonds $25.3 Billion
  ▪ 178 are 55%, 6 are 2/3 vote

✓ 116 two-thirds vote bonds, special taxes, parcel taxes
  ▪ Including 12 non-school G.O bonds totaling $7.3 billion

✓ 133 city / county majority vote general purpose taxes

Local Revenue Measures November ‘16

✓ 12 city, county, special district G.O. bonds $7.3 Billion

✓ 88 sales (transactions & use) taxes including
  ▪ 13 countywide transportation taxes
  ▪ 58 majority vote general purpose

✓ 39 non-school parcel taxes
  ▪ 28 special district parcel taxes (fire, parks, police, roads, hospital)

✓ 21 hotel occupancy taxes
✓ 9 utility user taxes

Types of Non-School Local Tax Measures
November 2016

Sales Tax, 58
Hotel Tax, 16
Bus & Lic Tax, 36
Parcel Tax, 39
G.O. Bond, 12
Prop Transf Tax, 2
Other, 11
Utility User Tax, 1
Pot Lic Tax Special, 1
Sales Tax Special, 30
Hotel Tax Special, 5

Local Revenue Measures November ‘16

Why the record number?

✓ Prop 51 State School Bond & Prop 55 income tax extension.
  ▪ Synchronous opportunity
✓ Extensions / renewals - some existing taxes will expire soon.
✓ Cannabis, Prop 64 - initiatives, government action to regulate, tax.
✓ Accommodating new tech in taxes (UUTs, TOTs)
✓ Transportation funding needs - no state solution yet.
✓ Cost pressures: pensions, OPEBs
✓ Local sales tax decline (concentration, kickbacks)
✓ Prop 30 ¼% state sales tax ends 12/31/2016

Local Tax and Bond Measures
June 2016

- General Tax Majority Vote Measures
  - Since 2001 66%
  - 87% (13/15)

- Special Tax 2/3 Voter Measures
  - Since 2001 47%
  - 48% (10/21)
Other Local Measures of Note November ‘16

- Term limits: 7 cities, 2 school districts.
- District elections: 8 cities.
- Charter reform: San Bernardino
- Pension reform: San Jose
- Growth control: 20 cities
- Rent control: 9 cities
- Sales tax repeal referendum: Stanton.
- Wastewater rate referendum: Oxnard
- Appointed Clerk (4), Appointed treasurer (3)

Transportation Funding in California: IT’s Time for a New Vehicle

Michael Coleman
Local Streets and Roads Funds
(from State Highway User Tax)

Transportation Funding in California

User Charges
- Federal Fuel Taxes
- State Fuel Taxes
- Vehicle Registration Fees
- Vehicle Weight Fees
- Cap-n-Trade Funds
- Tolls
- Public Transit Fares

General Support
- Dedicated Sales Taxes (incl. “self help”)
- Local ¼% T.D.A. Sales Tax
- Benefit Assessments and Mello-Roos Taxes
- Developer Fees and Exactions
- Dedicated Parcel Taxes
- Local General Fund (incl. G.O. Bond Debt Service)
- Redevelopment Tax Increment

Local Streets and Roads Funds
§2103 swap
§2104 counties
§2105 cities & counties
§2106
§2107 cities

Transportation Funding

Estimated
Projected
Transportation Funding Squeeze

Fuel tax revenues are flat /declining
- Per gallon rate is stagnate re inflation
- Shift to alternative fuels
- Price based rate has tanked swap mechanism makes it worse

Local general funds squeezed by:
- other service demands,
- recession,
- state take-aways,
- flawed sales tax structure
- growing pension/ OPEB costs.

State General Fund support is gone
- Weight fees now fund transportation debt
- General fund owes $879 million to transp. funds

Local sales taxes nearly tapped out? extend …but not increase
- Pension cost increases (especially police/fire) exceed revenue growth.
- OPEBs (i.e. retiree health care) liabilities are mostly unfunded.

Fix Our Roads Coalition – Roadmap to Consensus

Priorities
1. Significant investment,
2. Focus: maintain / rehab current system,
3. New revenue into high priority goods movement,
4. Raise revenue across a broad range of options,
5. Split revenue equally btw state and local systems,
6. Strong accountability requirements,
7. Consistent annual funding levels.
Fix Our Roads Coalition – Roadmap to Consensus

Reforms/Other Provisions

✓ Sensible CEQA reforms
✓ Office of Inspector General
✓ Reduce duplicative state/fed rules
✓ Increase Caltrans encroachment permit threshold
✓ Enact Advanced Mitigation Program
✓ Constitutionally protect existing & new revenues for transp’t’n
✓ Provide spending transparency and accountability
✓ Require measureable performance targets
✓ Require cities and counties to adopt a maintenance of effort
✓ Require CTC allocation of SHOPEP support costs
✓ Provide Caltrans w flexibility re contracting out
✓ Eliminate sunset on authorization of Public Private Partnerships

Fix Our Roads Coalition – Roadmap to Consensus

Restore Lost Revenues

✓ Restore truck weight fees to transportation over 5 years to $1 billion/yr
✓ Reset the price-based gas excise tax rate to 17.3 cents +$900 million/year
✓ Repay all General Fund transportation loans, return OHV Prop 42 fuel tax revenues, and non-Article XIX protected funds back to transportation
  ▪ $765 million one time plus $165 million /yr ongoing

New Revenues

✓ Increase gas excise tax by 12 cts over 3yrs to $1.8 billion/yr
✓ Increase the diesel excise tax by 11 cents … $300 million/yr
✓ Road access fee = $65 … $2 billion /yr
✓ Zero emission vehicle fee = $100 … $10 million /yr
✓ $500 million from Cap and Trade
✓ Increase diesel sales tax rate 1.75% to 5.25% …$300 million /yr
✓ Index the excise tax rates
Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Risky financing schemes
- Over-reliance on redevelopment revenues
- Unsustainable and Intractable employee compensation especially public safety pension and retiree health care
- Unsustainable Decline in Core Revenues
- Ceding of management and policy choices to others
- Fear & Denial
- Toxic relationships
You Need the Financial Health Diagnostic

- **Validate** areas in which your city is fiscally healthy
- **Identify problems**, areas to improve
- **Act to remedy** problems before they get worse or unmanageable
- **Avoid being blind-sided** by problems
- **Add credibility** to your fiscal evaluation
- **Help others** (labor associations, taxpayers and other interested parties) **understand** your financial position

⇒ Get it at [www.CaliforniaCityFinance.com](http://www.CaliforniaCityFinance.com)

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California’s Troubled Sales and Use Tax

Michael Coleman
Sales Tax Collections

Source: California State Board of Equalization (Sales Tax), CA Dept of Finance (Population), CA Dept of Industrial Relations (CPI)

Revenues per capita inflation adjusted

Local 1% Sales Tax Revenue as a Percent of Personal Income

Population is aging
✓ spending on taxable items declines with age

Consumer spending growth is in:
✓ Housing
✓ Healthcare
✓ Food
✓ Entertainment
✓ Education

Tax growth is concentrating in distribution centers
✓ Major amounts kicked-back to corporations - not to public services

Some taxable goods being replaced by non-taxed digital equivalents:
✓ computer software
✓ music
✓ movies
✓ games
✓ books

Source: California State Board of Equalization (Sales Tax), US Dept of Commerce Bureau of Economic Analysis (California Personal Income)

Includes triple dip in new property tax
## Services Commonly Taxed in Other States ... But Not California

<table>
<thead>
<tr>
<th>Service</th>
<th>Texas</th>
<th>Florida</th>
<th>Utah</th>
<th>#States*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional sports (34), amusement parks (34), circus/fairs (33), cultural events (29), bowling alleys (26)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>26-34</td>
</tr>
<tr>
<td>Private club memberships, golf</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>23</td>
</tr>
<tr>
<td>Health clubs</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>22</td>
</tr>
<tr>
<td>Marina services</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>19</td>
</tr>
<tr>
<td>Laundry / dry cleaning</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>21</td>
</tr>
<tr>
<td>Garment, shoe repair or alteration</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>19</td>
</tr>
<tr>
<td>Automobile repair (20), washing (19), rustproofing (24)</td>
<td>-</td>
<td>X</td>
<td>X</td>
<td>19-24</td>
</tr>
<tr>
<td>Appliance (incl. TV) repair (23), installation (22)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>22-23</td>
</tr>
<tr>
<td>Carpet / upholstery cleaning</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>17</td>
</tr>
<tr>
<td>Remodeling – Labor</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>14</td>
</tr>
<tr>
<td>Exterminating</td>
<td>X</td>
<td>X</td>
<td>-</td>
<td>19</td>
</tr>
<tr>
<td>Landscaping / lawncare</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>20</td>
</tr>
<tr>
<td>Swimming pool cleaning</td>
<td>X</td>
<td>-</td>
<td>-</td>
<td>16</td>
</tr>
<tr>
<td>Digital downloads</td>
<td>X</td>
<td>-</td>
<td>X</td>
<td>23</td>
</tr>
</tbody>
</table>

Source: Mazerov "Expanding Sales Taxation of Services: Options and Issues, Center on Budget and Policy Priorities

*States plus District of Columbia

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## Taxation of Digital Sales in the States (2012)

![Map showing states with and without taxation of digital sales](source:Mazerov 2012)
Lost Revenue to California From Not Applying the Sales Tax to …

<table>
<thead>
<tr>
<th></th>
<th>State 7.5%</th>
<th>Local 1%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digital goods (books, music, games, movies and software)</td>
<td>$130</td>
<td>$18</td>
</tr>
<tr>
<td>Recreation and entertainment: professional sports, amusement parks, cultural events, circus / fairs, bowling alleys, video, billiards, marina services, health clubs, private club memberships.</td>
<td>$1,920</td>
<td>$256</td>
</tr>
<tr>
<td>Maintenance and repair: carpet and upholstery cleaning; extermination; landscaping; yard care; swimming pool maintenance / cleaning; building repair/remodeling, automobile repair, appliance repair/installation; garment/ shoe repair/alteration, laundry/dry cleaning.</td>
<td>$2,585</td>
<td>$345</td>
</tr>
<tr>
<td>Candy, snacks, bottled water exemption – eliminate</td>
<td>$1,160</td>
<td>$155</td>
</tr>
<tr>
<td>Custom computer program exemption – eliminate</td>
<td>$375</td>
<td>$50</td>
</tr>
</tbody>
</table>

Defining Situs
Where Does the Sale Take Place in Remote Sales?

What is the location of the sales transaction (the situs)?

- Seller’s location? Location of product receipt? Product location?
- California currently uses “origin sourcing,” the situs is the retailer’s place of business where negotiations take place.

Origin sourcing often => concentration of tax revenue

- far in excess of service costs at the office or warehouse location
- economic activity, service impacts also occur elsewhere (i.e., where product is used)
15% to 20% of total local sales taxes paid statewide are now rebated back to corporations rather than funding public services.

**Sales Tax Sharing Agreements are Eating Our Revenue Base**

When is the give-away of taxpayer dollars justified?

Local 1% Sales Taxes

- retained for public services
- rebated to corporations

Over $1 Billion /yr

20% of the $6 bil / yr local 1% rate = $1.2 bill

Stopping sales tax kickbacks would not limit:
- other forms of “assistance”
- buying companies, expansions, relocations, etc.

Sales Tax Sharing Agreements are Eating Our Revenue Base

**Solution: Redefine “sourcing” rules to situs of receipt**

- Does not change over the counter sales.
- Allocates remote sales to where product is received by the purchaser.
- Broader distribution among all cities.
- Closer distribution to overall economic activity / service impact.
- Could phase-in and/or split source (origin/receipt).
- Reduces incentive for sales tax rebate agreements.
- Returns as much as $1 billion back to city general funds.

20% of the $6 bil / yr local 1% rate = $1.2 bill

Sales Tax Sharing Agreements are Eating Our Revenue Base

**Solution: Strictly limit or prevent new sales tax rebate agreements.**

- Eliminate loopholes that allow rebates where there is no net new economic benefit among California communities.
- SB533 (Pan) right direction but enough?
Remote Sales Tax Legislation

Empowering States to Enforce Collection of Remote Sales Tax

<table>
<thead>
<tr>
<th>Marketplace Fairness Act S.698</th>
<th>Online Sales Simplification Act (OSSA) – House Judiciary Com</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sourcing</td>
<td>Hybrid. Retailer’s state’s base (origin) at single buyer’s state rate (destination)</td>
</tr>
<tr>
<td>California currently uses “origin sourcing,” the situs is the retailer’s place of business where negotiations take place.</td>
<td></td>
</tr>
<tr>
<td>Sourcing system</td>
<td>Destination based. Buyer’s state may require out-of-state vendors to collect tax at rate determined by the state.</td>
</tr>
<tr>
<td>Destination based. Buyer’s state may require out-of-state vendors to collect tax at rate determined by the state.</td>
<td></td>
</tr>
<tr>
<td>Small seller exemption</td>
<td>Remote sellers with ≤$1M total U.S. annual remote gross receipts of in preceding calendar year.</td>
</tr>
<tr>
<td>Collecting state must provide software</td>
<td>No exemption</td>
</tr>
</tbody>
</table>

Minimum simplification provisions - must be adopted by state

- California currently uses “origin sourcing,” the situs is the retailer’s place of business where negotiations take place.

Sourcing system

- Destination based. Buyer’s state may require out-of-state vendors to collect tax at rate determined by the state.

Are Incorporations and Annexations Extinct?

Pernicious Effects of the VLF-Property Tax Swap of 2004

Michael Coleman
The VLF-Property Tax Swap of 2004

State General Fund

VLF Backfill

Cities & Counties

Property Tax in Lieu of VLF

Schools

* in FY2004-05

The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

Denied PropTax AB1602 of VLF that all other cities get
The Lack of VLF Replacement Makes Many Annexations Fiscally Unviable

Annexation of Inhabited Area example

Millions

If incorporated before 2004 swap

After Swap

w/AB1602 VLF patch (assumed in annex process)

Actual (after SB89 shift)

VLF

Property Tax

SalesTax

Other

VLF

Property Tax

SalesTax

Other

VLF

Property Tax

SalesTax

Other

VLF

Property Tax

SalesTax

Other

VLF

Property Tax

SalesTax

Other

Denied PropTax
th under VLF that all other
areas of city get

39

40