As trustees of the city, elected officials and city managers have special and serious obligations to safeguard the fiscal assets of the public. The panel of experts will start with an overarching financial picture of state and local government finance in California and delve into essential aspects of municipal finance that every city councilmember should know. Learn how cities have gotten into financial trouble and the right questions to ask to know if yours is healthy. Gain insight into major trends, challenges ahead and possible reforms. Obtain essential skills to keep your city budget strong through tough economic times. Determine best practices in financial reporting and identify important questions to ask when building the city budget. Get your questions answered from peers and panelists.

Michael Coleman, Fiscal Policy Advisor, League of California Cities, CaliforniaCityFinance.com
Katie Lichtig, City Manager, San Luis Obispo
Drew Corbett, Assistant City Manager / Finance Director, San Mateo

### Workshop Outline

1. Your role as council member
2. Financial Policies
3. Budgets and budget processes
4. Financial reporting and auditing
5. City Funds: Taxes, Fees and Other Major Revenues
6. Pension and OPEB costs
7. Capital financing and debt management
8. Ethical issues; purchasing best practices
9. Cash management and investments
10. Milestones in municipal finance: a brief history, the state-local relationship
11. Diagnosing financial health
12. Top tips, closing charges, and Q&A

### Course Materials - attached

1. Power point presentation slides.
2. Chapter 1, 2.0 and glossary from The California Municipal Revenue Sources Handbook 2014ed
5. “Top City Finance Tips for City Councilmembers,” Michael Coleman

### Also Recommended

Overview

• Financial Administration: Your Role as a Council Member
• Financial Policies
• The Budget and Budget Process
  o Break and Q & A (~10:30am)
• Financial Reporting and Auditing
• Ins and Outs of City Funds: Taxes and Major Revenues
• Pensions and OPEBs
• Capital Financing and Debt Management
• Ethical Issues and Purchasing
  o Lunch and Questions & Answers (~12:15pm)
• Cash Management and Investments
• Milestones in California Municipal Finance, the State-Local Relationship
• Diagnosing Financial Health, Financial Planning
• Top Tips
• Questions & Answers

Conclude 3:00pm
Financial Administration and Your Fiduciary Role

• The Fiduciary Role of Mayors and Councilmembers
• Roles of Key Staff

Katie Lichtig

City Council Member Roles

• Adopt policies
  o regulations, ordinances, resolutions
• Set strategic vision and priorities
• Adopt/amend the General Plan
  o consider land use proposals
• Appoint Commissions and Boards
• Serve on committees
• Appoint City Manager & Attorney

Act as a fiduciary agent for your City
  o Including approving a balanced City budget
Your Fiduciary Role

- City Council has **fiduciary duty** to oversee the budget
- City Council has the **legal authority** to appropriate financial resources for operations, capital and equipment
- The Budget **allocates limited staff and financial resources**
- City Council **sets financial policies** for the agency

The Fiduciary Role of Mayors and Councilmembers

**Oversight**
- Budget Review/Approval
- Public Contracts
- Labor Relations

**Sound financial policies**
- Setting parameters
- Ensure long and short term financial awareness

**Fiscal & Service Impacts of Decisions**
- Setting precedents and unintended consequences
**Staff’s Fiduciary Role**

- prepares & monitors operating and capital budgets
- develops long term financial plans
  - including economic forecasts and assumptions
- handles all ongoing daily operations of the city’s accounting activities
- completes compliance and fiscal audits; prepares Annual Financial Report
- ensures compliance with laws, regulations, standards

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**Functions Within a Typical Finance Department**

- Accounting / Financial Reporting
- Budget / Financial Planning
- Accounts Payable
- Treasury / Investments
- Payroll
- Banking / Cash Management
- Capital Financing / Debt Administration
- Revenue Administration
- Purchasing
Financial Policies: The Foundation of Fiscal Health

Katie Lichtig

- Plans versus Policies
- Topics for Financial Policies
- Policy versus Practice: Make 'em Work
- Policies and Financial Ratings

Plans versus Policies

- Plans can change over time (like ... as soon as the ink is dry)
- Policies, however....
  - Act as your “north star,” guiding your actions
  - Make tough decisions easier by formalizing values and procedures before a crisis hits
  - You could decide to do something else
  - Bottom line... good policies always give you a starting point
Financial Policy Topics

- Balanced Budget
- User Fees & Cost Recovery
- Enterprise Funds: To subsidize or not?
- Fund Balance & Reserves
- Budget Amendments
- Budget Carryover
- Revenue Earmarking
- Capital Financing & Debt Management
- Financial Reporting
- Investments
- Purchasing, bidding, contracting
- Travel guidelines
- Credit Card Use

Case Study: SLO Fee Update

Factors

- Effect of pricing on the demand for services
- Service recipient (e.g., the community) versus service driver (e.g., the applicant)
- Feasibility of collection and recovery
- Setting User Fee Recovery Levels

Community-wise versus special benefit

100% Cost of Service
Formal Policies

- Put financial policies in writing so that they:
  - Can outlive the crisis or prepare you for one
  - Promote stability and continuity
  - Create efficiency through standardization
  - Save you debt service costs
  - Don’t rely on an individual to interpret best practices
  - Help with your financial reporting and reduce Audit findings

Crucial Point: Policy versus Practice

- Policy should include specific objectives, but not detailed steps in meeting those objectives
- Make policy brief and concise.
  - Example: “User fees should be reviewed and updated every five years to adjust to changes in cost-of-living and service delivery.”
- Include “how to” steps in administrative procedure, if necessary.
- Leave exact steps of review/adjustment to staff.
Relationships Exist Between…. Financial Ratings & Agency Policies

**Very Significant**
- Fund balance policy
- Debt affordability policy
- Unfunded liabilities

**Significant**
- Pay-as-you-go capital financing
- Multi-year forecasting
- Quarterly reporting
- Quick debt retirement

**Influential**
- Contingency plans
- Non-recurring revenue policy
- Depreciation of fixed assets (GASB 34)
- 5 Year CIP integrating operating cost impacts
- GFOA budgeting award
- Economic Devel. Incentives

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**Fiscal Policies To Do’s**

1. Do you have needed policies?
2. When were they last reviewed/refreshed?
3. How is Council informed of compliance?
4. What keeps you up at night?
   1. Would a policy help???
Roundtable Discussion

• What did you do to prepare for working on the budget?
• What was the most surprising thing you learned?
• What was the most helpful advice you’ve received?
• What could your City Manager have done differently to help prepare you?
• What advice do you have for other elected officials?
What is a Budget?

- A **budget** is an **estimate** of revenues and expenditure for a set period of time.

The budget should achieve the following:
- Balanced revenues and expenditures
- Reflect the community’s priorities
- Good estimates of revenues/expenses by fund
- Anchored to Long Term Forecasts
  - minimum of five years
- Provide actual revenue/expense history to gauge accuracy of forecasts!

What is in a Budget?

- A **summary or discussion** of revenues and expenses
- History of **actual** revenues and expenses
- Projected **revenues by type/source**
- Estimates of proposed **expenditures by function** (typically by City Department)
- Separate budgets for each and every **fund**
- Capital Budget – tied to CIP
What is a “Fund”? 

• A fund is a self-balancing set of accounts for all financial transactions of specific activities.

• Most agency budgets include the following types of separate “funds”:
  - General Fund
  - Enterprise Fund(s) e.g. water, sewer, trash
  - Special Revenue Fund(s)
  - Capital Project Fund(s)
  - Others: debt service, trust, agency, internal service, special assessment

Beyond the Budget…

There is a lot more to financial oversight than the budget!

• Pay close attention to fiscal policies and procedures, such as:
  - Expenditure & Authorization limits
  - Reserve levels for various funds

Share what your budget is doing it’s not about the #'s
What’s Your Budget Story?

Katie Lichtig

Budget in Brief
Critical Story Elements

- What are the key messages?
- Who is your audience?
- How are you delivering the messages?
- Persons and pictures preferred
- Determine the best technology tools for delivery
Annual process culminates with production of the Comprehensive Annual Financial Report (CAFR)

Unfortunately...

“In a perfect world, the information in financial statements would be readily understandable to anyone with an interest in the information. More realistically, the stated purpose of general purpose external financial reporting is to provide information that will be understandable to someone with a reasonable understanding of government and public finance activities and of the fundamentals of governmental financial reporting.”

From GASB Concepts Statement No. 3
Comprehensive Annual Financial Report (The CAFR)

- Letter of Transmittal
- Independent Auditor’s Report
- Management Discussion and Analysis
- Basic Financial Statements and Note Disclosures
- Supplementary Information and Statistical Section

Letter of Transmittal

- Introduction to the CAFR
- Background on the agency
- Major initiatives
- Economic outlook
- Financial planning and fiscal policies
Independent Auditor’s Report

- Management’s responsibility vs. auditor’s responsibility
  - Management: Fair presentation of financial statements based on Generally Accepted Accounting Principles (GAAP)
  - Auditor: Opinion on financial statements based on audit

- Auditor’s opinion
  - Ideal result is unmodified opinion that financial statements fairly present financial position of the agency

- Comments on Report on Internal Control
  - Separately issued letter
  - Contains any findings, management’s response

Management’s Discussion and Analysis (MD&A)

- Narrative overview of Basic Financial Statements
  - Explains components
  - Highlights year-over-year changes
  - Analysis of individual funds

- What to look for:
  - Changes in net position
    - Capital assets vs. unrestricted net position
    - Underlying reasons …. One-time occurrences or a trend?
  - Changes in fund balance
    - The change itself is less important than the explanation
  - Analysis of the General Fund
### Basic Financial Statements

**Government-wide**
This is the agency-wide roll-up

#### Governmental Funds
- General Fund
- Special revenue funds (e.g., impact fee funds)

#### Proprietary Funds
- Enterprise funds (e.g., utilities, etc.)

#### Fiduciary Funds
- Trust funds (e.g., redevelopment dissolution funds, etc.)

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### Government-wide Financials

<table>
<thead>
<tr>
<th>Statement of Net Position</th>
<th>Governmental Activities</th>
<th>Business-Type Activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>$500,000</td>
<td>$30,000</td>
<td>$530,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>$100,000</td>
<td>$5,000</td>
<td>$105,000</td>
</tr>
<tr>
<td>Net position</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Assets</td>
<td>$325,000</td>
<td>$15,000</td>
<td>$340,000</td>
</tr>
<tr>
<td>Restricted for:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Projects</td>
<td>$15,000</td>
<td>$8,000</td>
<td>$23,000</td>
</tr>
<tr>
<td>Debt Service</td>
<td>$5,000</td>
<td>$0</td>
<td>$5,000</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>$55,000</td>
<td>$2,000</td>
<td>$57,000</td>
</tr>
<tr>
<td><strong>Total Net Position</strong></td>
<td>$400,000</td>
<td>$25,000</td>
<td>$425,000</td>
</tr>
</tbody>
</table>
Fund Financials

**Governmental Funds**
- Focus on current financial resources
  - Modified accrual accounting
  - The “checkbook” approach
- Fund financials and government-wide financials will not look the same
  - No capital assets
  - No long-term liabilities

**Proprietary Funds**
- Focus on economic resources
  - Full accrual accounting
  - The “business-like” approach
- Fund financials and government-wide financials will look the same

---

**Governmental Funds – Balance Sheet**

<table>
<thead>
<tr>
<th></th>
<th>General Fund</th>
<th>Major Funds</th>
<th>Non-Major Funds</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>$50,000</td>
<td>$20,000</td>
<td>$40,000</td>
<td>$110,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>$15,000</td>
<td>$5,000</td>
<td>$10,000</td>
<td>$30,000</td>
</tr>
<tr>
<td>Fund Balance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-spendable</td>
<td>$1,000</td>
<td>$0</td>
<td>$0</td>
<td>$1,000</td>
</tr>
<tr>
<td>Restricted</td>
<td>$0</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Committed</td>
<td>$20,000</td>
<td>$0</td>
<td>$15,000</td>
<td>$35,000</td>
</tr>
<tr>
<td>Assigned</td>
<td>$4,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$14,000</td>
</tr>
<tr>
<td>Unassigned</td>
<td>$10,000</td>
<td>$0</td>
<td>$0</td>
<td>$10,000</td>
</tr>
<tr>
<td><strong>Total Fund Balances</strong></td>
<td>$35,000</td>
<td>$15,000</td>
<td>$30,000</td>
<td>$80,000</td>
</tr>
</tbody>
</table>
Notes to the Basic Financial Statements

• Note disclosures
  o Significant accounting policies
  o Details on
    • Cash and investments
    • Capital assets
    • Long-term debt
    • Pension and OPEB

• Important back-up to the financial statements

Supplementary Information

• Required Supplementary Information
  o Management’s discussion and analysis
  o Budgetary reporting
  o Pension and OPEB reporting

• Other supplementary information
  o Detailed financials for non-major funds
  o Other financial schedules
## General Fund Comparison Schedule

<table>
<thead>
<tr>
<th></th>
<th>Original Budget</th>
<th>Final Budget</th>
<th>Actuals</th>
<th>Variance to Final Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$40,000</td>
<td>$42,000</td>
<td>$43,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Expenditures</td>
<td>$40,000</td>
<td>$41,000</td>
<td>$40,500</td>
<td>$500</td>
</tr>
<tr>
<td>Revenues Over (Under) Expenditures</td>
<td>$0</td>
<td>$1,000</td>
<td>$2,500</td>
<td>$1,500</td>
</tr>
<tr>
<td>Net Change in Fund Balance</td>
<td>$0</td>
<td>$1,000</td>
<td>$2,500</td>
<td>$1,500</td>
</tr>
<tr>
<td>Beginning Fund Balance</td>
<td></td>
<td></td>
<td>$12,500</td>
<td></td>
</tr>
<tr>
<td>Ending Fund Balance</td>
<td></td>
<td></td>
<td>$15,000</td>
<td></td>
</tr>
</tbody>
</table>

## Statistical Section

- Unaudited section of contextual information
  - Financial trends
  - Revenue capacity
  - Debt capacity
  - Demographics
  - Other operating information
The Ins and Outs of City Funds

Michael Coleman

- Taxes, Fees
- Local Property Taxes
- Local Sales Taxes

Cities Vary
... and so do their finances

- Geography: proximity, climate, terrain, access
- Community Character / Vision: Land use
- Size - urban / rural
- Governance / service responsibilities
  - full service city - vs. - not full service

- Statewide generalizations often mask trends among sub-groups
The Mechanics of Government Revenue

Who decides?
- Statewide voters / Constitution
- State law / Legislature
- Local voters
- Local law / City Council

Who pays?
- visitors, residents, businesses, etc.

What rate / base?
- $per gallon, %per price, depreciated value, etc.

How's it allocated?
- situs; pooled/population, etc.

What is the $ used for?
- general, water, roads, parks, etc.

Who collects? & enforces payment?

Taxes

✓ Charges which pay for public services and facilities that provide general benefits. No need for a direct relationship between a taxpayer’s benefit and the tax paid.

✓ Cities may impose any tax not otherwise prohibited by state law. (Gov Code § 37100.5)

✓ The state has reserved a number of taxes for its own purposes including:
  - cigarette taxes, alcohol taxes, personal income taxes.

✓ General & Special
  - General Tax - revenues may be used for any purpose.
    - Majority voter approval required for new or increased local tax
  - Special Tax - revenues must be used for a specific purpose.
    - 2/3 voter approval required for new or increased local tax
    - Parcel tax - requires 2/3 vote
Fees and the Rest

Any levy, charge or exaction of any kind imposed by a California government, is a **tax** except:

- **User Fees and Assessments**: for a privilege/benefit, service/product
  - Planning permits, development fees, parking permits, user fees, copying fees, recreation classes, etc.
- **Regulatory Fees**: regulation, permits, inspections
  - Permits for regulated commercial activities (e.g., dance hall, bingo, card room, check cashing, taxicab, peddlers, catering trucks, massage parlor, firearm dealers, etc.); fire, health, environmental, safety permits; police background checks; pet licenses; bicycle licenses.
- **Rents**: charge for entrance, use or rental of government property
  - Facility/room rental fees, room rental fees, equipment rental fees, on and off-street parking, tolls, franchise, park entrance, museum admission, zoo admission, tipping fees, golf green fees, etc.
- **Penalties** for illegal activity, fines and forfeitures, etc.
  - Parking fines, late payment fees, interest charges and other charges for violation of the law.
- **A payment that is not imposed** by government
  - Includes payments made pursuant to a voluntary contract or other agreement that are not otherwise “imposed” by a government’s power to coerce.

Taxes and Fees/etc.

### Approval Requirements

*(California Constitution)*

<table>
<thead>
<tr>
<th></th>
<th>Tax-General</th>
<th>Tax-Parcel or Special ( earmarked)</th>
<th>G.O.Bond (w/ tax)</th>
<th>Fee / fine / rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>City / County</td>
<td>Majority voter approval</td>
<td>Two-thirds voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>Special District</td>
<td>n/a</td>
<td>Two-thirds voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>K-14 School</td>
<td>n/a</td>
<td>Two-thirds voter approval ( parcel tax)</td>
<td>55% voter approval*</td>
<td>Majority of the governing board.*</td>
</tr>
<tr>
<td>State</td>
<td>For any law that will increase the taxes of any taxpayer, two-thirds of each house of the Legislature ...or an approval of majority of statewide voters.</td>
<td>Statewide majority voter approval</td>
<td>Majority of each house.</td>
<td></td>
</tr>
</tbody>
</table>
California’s Tax Revenue Structure

**STATE**
- Personal Income $60.8B
- Corporate $8.5B
- Other state
- Sales & Use $34.3B
- VehLicFee (Tax) $1.9B
- Motor Veh Fuel $7.2B

**LOCAL**
- Property Tax $51.3B
- Local Sales Tax, TrUT $11.6B
- Other state
- Property Transfer $0.4B
- Utility Users $1.8B
- Parcel Tax, other $3.0B
- Business License $1.0B

*Not shown: user fees, franchises and other misc revenues

**The Ins and Outs of State & Local Funds**

- 70% to local schools and counties, for state programs provided locally
- Locally imposed sales taxes
  - collected by state BOE,
  - allocated to cities & counties
- $16B offsets state costs for schools
- Locally imposed, collected & spent

**California City Revenues**

- Taxes
- Fees
- State/Fed Aid
- Rents, penalties
- Other

**Not Restricted 35%**
- Utility Fees (Water, Sewer, Refuse, Electr, Gas, etc.) 28%
- Other Fees 12%
- Devpt Fees & Permits 2%
- Licenses & Permits <1%
- Fines & Forfeitures 1%
- Federal Grants 5%
- State Grants 4%
- Benefit Assessments 2%
- Special Taxes 4%

**Property Tax 13%**
- Benefit Assessments 2%
- Special Taxes 4%

**Sales Tax 7%**
- BusnLicTax 2%
- Utility User Tax 3%
- TransOccTax 2%
- Other Tax 3%
- Franchises 2%
- State & Fed 1%
- Other 3%

Source: CaliforniaCityFinance.com computations from data from California State Controller (revenues). Does not include data from the following cities that failed to report: Beaumont, Hawthorne, Imperial, La Habra, Lindsay, Placerville, Stockton, Taft, and Westmorland.
The Ins and Outs of State & Local Funds

Discretionary Revenues and Spending

Typical Full Service City

Revenues

- Property Tax
- Sales & Use Tax
- Franchises
- Utility User Tax
- BusnLic Tax
- Hotel Tax
- Other

Expenditures

- Fire
- Police
- Parks&Rec
- Library
- Streets
- Planning
- Other

Source: Coleman Advisory Services computations from State Controller reports

California County Revenues

- Property Tax 22%
- State Grants 32%
- Federal Grants 20%
- Service Fees 15%
- Licenses, Permits 1%

- Sales Tax 1%
- Other Taxes 4%
- Fines, Forfeitures 2%
- Interest, Rents 1%
- Other 2%

Counties are hybrid local/state

- countywide services: jails, courts, elections, property tax collection & allocation.
- “city” services to unincorporated areas

Source: CaliforniaCityFinance.com computations from data from California State Controller.
Property Tax

✔ An ad valorem tax imposed on real property and tangible personal property
✔ Maximum 1% rate (Article XIII A) of assessed value, plus voter approved rates to fund debt
✔ Assessed value capped at 1975-76 base year plus CPI or 2%/year, whichever is less
✔ Property that declines in value is reassessed to the lower market value.
✔ Reassessed to current full value upon change in ownership (with certain exemptions)
✔ Allocation: shared among cities, counties and school districts according to state law.

Where Your Property Tax Goes

Shares Vary!
✔ Non-Full service cities: portion of city shares go to special districts (e.g. fire)
✔ Pre-prop13 tax rates

Source: Coleman Advisory Services computations from Board of Equalization and State Controller data.
Sales and Use Tax

✔ **Sales Tax**: imposed on the total retail price of any tangible personal property

✔ **Use Tax**: imposed on the purchaser for transactions in which the sales tax is not collected.

Where Your Sales Tax Goes

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>City*</td>
<td>1.00</td>
</tr>
<tr>
<td>Co Transp</td>
<td>0.25</td>
</tr>
<tr>
<td>Prop 172</td>
<td>0.50</td>
</tr>
<tr>
<td>Co Realign</td>
<td>1.5625</td>
</tr>
<tr>
<td>State GF</td>
<td>3.9375</td>
</tr>
<tr>
<td>Total Base</td>
<td>7.25%</td>
</tr>
</tbody>
</table>

* For taxable sales in unincorporated areas, the local 1% rate goes to the county.
Local 1% Sales Tax Revenue as a Percent of Personal Income

- The population is aging
- Spending on taxable items declines with age

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

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

- 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

Pensions and Other Post-Employment Benefits (OPEB)

- Pension Funding
- Employer Contribution Rates
  - What Happened?
- GASB changes
- Other Post Employment Benefits (OPEB)

Drew Corbett
Pension Funding

Pensions are funded from...

1. CalPERS investment earnings
2. Contributions from employers
   • Variable based on a variety of factors
3. Contributions from employees
   • Fixed based on pension formula

Employer Contribution

Two components

○ Normal cost
  • Annual cost of future benefit for current employees
  • Expressed as a percentage of pay

○ Payment on unfunded liability
  • Required when plan liabilities exceed plan assets
  • Expressed as a dollar amount and payment required regardless of payroll
Many factors cause the employer rate to change, including...

- CalPERS investment earnings
- Benefit changes
  - Formula changes applied retroactively
- Changes in actuarial assumptions
  - Economic, such as the rate of investment return
  - Demographic, such as mortality rates
  - Other experience
    - Pay increases exceeding assumptions
What Happened?

CalPERS Investment Returns

- Strong investment returns in the late 1990s created momentum for enhancing benefits
- But investment losses combined with more expensive benefits created significant unfunded liabilities
- Volatile returns have not improved the funded status of plans and have required CalPERS to take action

Where Are We Going?

- December 2016: CalPERS Board votes to lower discount rate from 7.5% to 7.0%

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Effective Year</th>
<th>Full Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.375%</td>
<td>2018-19</td>
<td>2022-23</td>
</tr>
<tr>
<td>7.250%</td>
<td>2019-20</td>
<td>2023-24</td>
</tr>
<tr>
<td>7.000%</td>
<td>2020-21</td>
<td>2024-25</td>
</tr>
</tbody>
</table>

- Will result in significant increase in contribution rates
Changes and Considerations

• Government Accounting Standards Board (GASB) Statement No. 68
  o Unfunded liability on balance sheet
    • Impacts your unrestricted net position
  o No impact to contribution rates
  o Effective since fiscal year 2014-15

• Unfunded liabilities
  o Accelerated payments to CalPERS
  o Irrevocable trust

Other Post-Employment Benefits (OPEB)

• Largely under-the-radar until GASB 45
  o Difference between Actuarial Required Contribution (ARC) and actual contribution on balance sheet
    o No requirement to fund, but creates visibility

• Significant liability for many cities

• Cost continuing to increase
  o More retirees
  o Retirees living longer
  o Increasing healthcare costs
OPEB Changes on the Horizon

• Net OPEB liability on balance sheet (GASB 75)
  o Similar to change implemented for pensions (GASB 68)
  o Effective for financial statements for year ending 6/30/18

• Implied subsidy
  o Cost for retiree healthcare > healthcare premium
    • Value of implied subsidy in GASB 45 valuation
      o Valuations on or after 3/31/15
      o Will increase liability

OPEB Considerations

• Funding OPEB liabilities
  o Actuarially-determined “Annual Required Contribution” vs. pay as you go
    • Via CalPERS or other irrevocable trust
    • Reduces long-term cost by increasing portion paid by investment earnings

• Adjusting benefits
  o Negotiable item with bargaining associations
  o More flexible than changes to pensions
Capital Financing and Debt Management

- Capital Assets
- Pay-go v Debt
- Financing Tools
- Major Players
- Bond Sale Options
- Continuing Disclosure

Examples of Capital Assets

- Facilities
- Vehicles and Equipment
- Land and improvements
- Infrastructure (water, sewer, streets)
Pay as You Go (Pay-Go) *versus* Pay as You Use (Debt)

<table>
<thead>
<tr>
<th>Pay-as-You-Go (Cash)</th>
<th>Pay-as-You-Use (Debt)</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Costs should not be imposed on future residents who have no say in the matter.</td>
<td></td>
</tr>
<tr>
<td>✓ Increasing debt outstanding may increase interest costs on future projects.</td>
<td></td>
</tr>
<tr>
<td>✓ The substantial savings in issuance and interest costs can be used to pay for operations or additional facilities.</td>
<td></td>
</tr>
<tr>
<td>✓ Using current revenues and sinking funds and to save for future asset needs encourages good financial management and planning.</td>
<td></td>
</tr>
<tr>
<td>✓ A greater legacy in the form of paid-up facilities is provided to future residents.</td>
<td></td>
</tr>
<tr>
<td>✓ An agency may not have the fiscal capacity to provide sufficient funds from current revenue — especially for large assets.</td>
<td></td>
</tr>
<tr>
<td>✓ Payment of costs can be synchronized with enjoyment of the benefits, or the useful life of the asset financed.</td>
<td></td>
</tr>
<tr>
<td>✓ In an inflationary economy, the average dollars in which funds are repaid may be of lesser value than those which are borrowed.</td>
<td></td>
</tr>
<tr>
<td>✓ Prudent use of debt financing allows a municipality more opportunities to use cash on hand.</td>
<td></td>
</tr>
</tbody>
</table>

Financing Capital Facilities

<table>
<thead>
<tr>
<th>Source/Tool</th>
<th>Approval Rules</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developer fees &amp; exactions</td>
<td>Condition of development</td>
<td>✓ Limited, one time</td>
</tr>
<tr>
<td>User Fees (Revenue Bond)</td>
<td>Majority protest for water, sewer, refuse</td>
<td></td>
</tr>
<tr>
<td>General Obligation Bonds (property tax)</td>
<td>2/3 voter approval (citywide)</td>
<td>✓ ad valorem tax increase</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Lowest interest cost</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Needs big communitywide interest</td>
</tr>
<tr>
<td>Special Benefit Assessment</td>
<td>Majority protest of payers (weighted)</td>
<td>✓ “special benefit” to property that pays also for maintenance</td>
</tr>
<tr>
<td>C.F.D. Special (Parcel) Tax</td>
<td>2/3 voter approval - if &lt;12 voters by landowner weighted vote</td>
<td>✓ also for maintenance, services</td>
</tr>
<tr>
<td>Certificates of Participation (COPs), Lease Rev. Bonds</td>
<td>City Council majority vote</td>
<td>✓ Contingent lease or installment sale</td>
</tr>
<tr>
<td>Tax Increment (R.I.P redevelopment)</td>
<td>55% of voters or within district for debt, if &lt;12 voters, by landowners</td>
<td>✓ New Enhanced Infrastructure Financing District (EIFD)</td>
</tr>
</tbody>
</table>
Enhanced Infrastructure Financing Districts (EIFDs)  SB628 (Beall, Wolk 2014)

- **Use:** public facilities and “projects of communitywide significance” including:
  - Highways, bridges, streets, parking, transit
  - Sewage treatment, water reclamation
  - Solid waste transfer & disposal
  - Wastewater collection & treatment
  - Flood control levees, dams, canals
  - Parks, recreation, open space, libraries
  - Brownfields restoration
  - Affordable housing
  - Child care
  - Transit priority projects
  - “Sustainable Community Strategy” projects
  - Industrial structures for private use

- Property tax increment of city* ≤ primary revenue
- Property tax increment of partner agencies (but NOT schools) e.g. county, special districts
- May combine with fees, assessments, grants, etc.
- Polanco Act Powers (for toxic remediation)
- Debt issuance -- **55% approval** of voters in district
- Must have Redevelopment Agency “Finding of Completion,” compliance with State Controller audit findings, conclusion of any outstanding legal issues.
Major (outside) Players in the Process

<table>
<thead>
<tr>
<th>Participant</th>
<th>Typical Role in Debt Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Public entity authorized by state law or city charter to issue debt, e.g., city, county, school district, special public/private agency. Issuer and issue must meet IRS requirements for federal tax exemption.</td>
</tr>
<tr>
<td>Investor</td>
<td>Mutual funds, high net worth individuals, investment trusts, insurance companies and banks.</td>
</tr>
<tr>
<td>Underwriter</td>
<td>Buys the debt and remarkets to investors. Assumes risk of reselling the debt for a fee. In a negotiated sales, the underwriter may provide many of the services of a financial advisor if one is not retained.</td>
</tr>
<tr>
<td>Bond Counsel</td>
<td>Provides legal opinion that the bonds are valid and binding obligations of the issuer, that the interest is tax-exempt, and legal terms of the debt issue.</td>
</tr>
<tr>
<td>Disclosure Counsel</td>
<td>Provides advice on issuer disclosure obligations and prepares official statements and/or continuing disclosure agreements.</td>
</tr>
<tr>
<td>Municipal Advisor</td>
<td>Assists and advises the issuer in formulating and executing a debt issuance.</td>
</tr>
<tr>
<td>Credit Rating Agencies</td>
<td>Organizations that assign a credit or risk rating to the debt being issued.</td>
</tr>
<tr>
<td>Trustee</td>
<td>Administrative functions defined in bond documents, e.g., paying interest.</td>
</tr>
<tr>
<td>Credit Enhancement</td>
<td>Provides a guarantee (through a letter of credit, bond insurance, etc.) that bond interest, principal will be repaid. Most municipal bonds carry bond insurance.</td>
</tr>
</tbody>
</table>

Typical Bond Sale Options

- **Competitive bidding**
  Underwriters submit a sealed bid for purchasing the bonds
  - Specific time on a specified date
  - Bidder offering lowest interest cost will get award

- **Negotiated sales**
  RFP sent to underwriters
  - Exclusive right to purchase at agreed upon prices
  - Room for negotiation with underwriter

- **Private placements**
  Issuers sell the bonds directly to investors or through a placement agent
  - No underwriter involved
  - Potentially less transparent; invite competition
  - More feasible for refundings than new money
Post-issuance Compliance

- Most issuances require continuing disclosure of
  - Ratings changes
  - Comprehensive Annual Financial Report
  - Budget document

- Scrutiny by U.S. Securities and Exchange Commission (SEC) has increased
  - Municipal Continuing Disclosure Initiative of 2014

- Arbitrage rebate calculation

Recent Regulatory Initiatives

- Municipal advisors must be registered
  - Securities and Exchange Commission
  - Municipal Securities Rulemaking Board

- Fiduciary duty to municipal clients
  - Must disclose any conflicts of interest

- Advice from underwriters limited
  - Agency must have Independent Registered Municipal Advisor, or
  - Underwriter retained for specific debt issue
Investment Regulation

- Local agency investments are regulated by California Government Code
  - Investment objectives
  - Role of governing body
  - Reporting requirements
  - Permitted investments
  - Methods of investing

- Investment policy
Investment Objectives (53600.5)

SAFETY ➔ LIQUIDITY ➔ YIELD

Role of Governing Body

- Governing Board (City Council) is trustee (53600.3)
  - Fiduciaries subject to prudent investor standard

- Authority to invest may be delegated (53607)
  - Treasurer/Finance Director/CFO
  - Annually renewed
    - Can be through investment policy approval
    - Investment policy can allow for third-party management
Reporting Requirements

- Government Code:
  - 53607 – Shall make monthly report of transactions
  - 53646 – May render quarterly report on holdings

- Best practice is quarterly reports that include, minimally
  - Type of issuer
  - Date of maturity
  - Par value
  - Current market value
  - Percentage allocation of securities
  - Statement on ability to meet expenditures

Permitted Investments

- Regulated by:
  - Government code (53600-53610)
  - Local agency’s investment policy

- Common permitted investments include:
  - U.S. Treasuries
  - U.S. Agencies (i.e. mortgage-backed securities)
  - Repurchase agreements
  - Medium-term corporate notes
  - Certificates of deposit
  - Municipal and state obligations
  - Prime commercial paper
  - Local Agency Investment Fund/County Investment Pools
**Permitted Investments**

<table>
<thead>
<tr>
<th></th>
<th>Overnight</th>
<th>180 Days</th>
<th>270 Days</th>
<th>1 Year</th>
<th>5 Years</th>
<th>Beyond 5 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>U.S. Treasuries</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Requires Approval</td>
<td></td>
</tr>
<tr>
<td><strong>Federal Agencies</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Requires Approval</td>
<td></td>
</tr>
<tr>
<td><strong>Municipal Securities</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Requires Approval</td>
<td></td>
</tr>
<tr>
<td><strong>Negotiable Certificates of Deposit</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Requires Approval</td>
<td></td>
</tr>
<tr>
<td><strong>Commercial Paper</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Requires Approval</td>
<td></td>
</tr>
<tr>
<td><strong>Banks’ Acceptances</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Requires Approval</td>
<td></td>
</tr>
<tr>
<td><strong>Medium-Term Corporate Bonds (“A” or Better)</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Prohibited</td>
<td></td>
</tr>
<tr>
<td><strong>Asset-Backed Securities (ABS)</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Prohibited</td>
<td></td>
</tr>
<tr>
<td><strong>Supranationals (“AA” or Better)</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Prohibited</td>
<td></td>
</tr>
<tr>
<td><strong>Repurchase Agreements</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Prohibited</td>
<td></td>
</tr>
<tr>
<td><strong>Mutual Funds/Money Market Funds</strong></td>
<td>Permitted</td>
<td>Permitted</td>
<td>Prohibited</td>
<td>Prohibited</td>
<td>Prohibited</td>
<td></td>
</tr>
<tr>
<td><strong>Local Government Investment Pools</strong></td>
<td>Permitted</td>
<td>Prohibited</td>
<td>Prohibited</td>
<td>Prohibited</td>
<td>Prohibited</td>
<td></td>
</tr>
</tbody>
</table>

**Methods of Investing**

- State law also prescribes process of investing (53601.5-53608)
  - Use of broker/dealers
    - Competitive transactions
    - Qualifications and conflicts
  - Delivery of securities and safekeeping (53608)
Investment Policy

- Foundation of investment goals and priorities
  - Defines city’s objectives and risk tolerance
- Optional under state law
- Best practice is annual review and approval by vote of legislative body
- Contains all of the previously covered information

Cash Management

- Cash management is important!
  - Managing liquidity
- Local Agency Investment Fund (LAIF) is important cash management tool
  - LAIF is part of State Pooled Money Investment Account
    - County investment pools may also be an option
      - Good balance of yield and liquidity for everyday cash management
Key Ethics Law Principles

1. No personal financial gain
2. No personal advantages or perks
3. Transparency
4. Fairness
Laws Governing Public Service

- Political Reform Act
- Interests in Contracts Prohibition
- State and Federal Criminal Bribery/Fraud/Civil Rights Laws
- Redevelopment Law
- Government Code and Penal Code
- California Constitution
- Common Law
- Public Contract Code
- Ralph M. Brown Act
- Public Records Act
- Labor Code
- State Elections Law
- Local Ordinances and Policies

Public Purchasing Context

- No personal financial gain and fairness are key aspects of public purchasing
- Perception plays large role
- Ethical and legal hazards
**Contractual Conflict of Interest**

- **Government Code Section 1090:**

  Members of the Legislature, state, county, district, judicial district, and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. Nor shall state, county, district, judicial district, and city officers or employees be purchasers at any sale or vendors at any purchase made by them in their official capacity.

**No Personal Financial Gain**

- Interest in agency contracts barred
  - California law

- Differentiates public official vs. staff
  - Public official with economic interest: No contract
  - Staff with economic interest: No staff involvement

- Recusal does not fix issue

- If contract affects financial interest, consult agency counsel

- Exceptions do exist
Fairness in Purchasing

• Public contracting laws designed for fairness
  o Opportunity for all interested parties
  o Assurance public receives best value

• Public works contracts competitively bid
  o California law + local authority

• Professional services exception
  o Demonstrate competence and professional qualifications
  o Architectural and engineering services

• Special services exception
  o Specialized training for required services
  o Legal and accounting services

• Perception, perception, perception

Final Considerations

• Ethics laws have much greater scope than just purchasing

• Get educated on laws
  o Understand what staff does
    vs. getting yourself/your agency into trouble

• Resources – California Institute for Local Government:
  www.ca-ilg.org/trust
  www.ca-ilg.org/everydayethics
Milestones in Municipal Finance: A Brief History

Michael Coleman

• Plans versus Policies
• Topics for Financial Policies
• Policy versus Practice: Make ‘em Work
• Policies and Financial Ratings

Proposition 13 (1978) nuts & bolts

1. One percent rate cap. Property tax rates capped at 1% of full market value
2. Assessment rollback of property values for tax purposes to 1975-76 levels
3. Assessment growth capped at 2% of property value (or CPI)
   o reassessment at full market value only upon change of ownership
4. Special taxes (local) require 2/3 voter approval
5. State tax increases require 2/3 vote of Legislature
6. Authority for allocating property tax revenues transferred to the state
Proposition 13 (1978) revenue impacts

- 57% reduction

The AB8 (1979) Bailout
Shifting Local Property Tax to Cushion Impacts of Prop13
Proposition 13 (1978) revenue impacts

The AB8 “Bailout”:
State legislature
- increased non-school shares,
- reduced school shares,
- paid more state general fund to schools.


Cities, Counties, Special Districts

Property Tax

State General Fund

Reduced general fund support

Schools
Local Revenue Protection:
Prop1A(‘04), Prop1A(‘06), Prop22(‘10)

Constitutional Protection for:

1. Property taxes: cities, counties, special districts
   Protection includes Property Tax in lieu of VLF (VLF swap)
   May reallocate among cities, counties, special districts
   with a 2/3 vote of both houses

2. Local sales tax rate, method of allocation
   Exception: interstate compact or federal law

3. VLF 0.65% rate to cities and counties ... unless replaced
   VLF may not be diverted to reimburse a state mandate

4. Transportation Funds to locals - no taking, delay or borrowing

5. Prohibitions against unfunded state mandates strengthened

6. Redevelopment Tax Increment - may not be diverted for other purposes

The State-Local Fiscal Relationship: A Rough Road

Fiscal constraints
Creative Response

Prop 13 Property Taxes
1978
1979
Prop 4 Spending Limits
Prop 218 Taxes, Fees, Assessments etc
1996
VLF "CarTax" cut & backfill

State Budget Trouble:
City & County VLF Taken, Many State Subventions Repealed
1981-1983
1986
Prop 47 VLF must go to cities/counties
Prop 62 votes on taxes

ERAF (Educational Revenue Augmentation Fund)
1992
SB2557 County Fees on Cities 1996
Prop 172 Public Safety Sales Tax

Prop 22 Local $ protection
2004
Redevelopment Property Tax Shifts
2008-2010
Prop 57 Sales Tax "Triple Flip"

Fiscal road concept stolen from LAO
Prop 42 State Sales Tax to Transportation
2002
Prop 57 Sales Tax "Triple Flip"
VLF-Property Tax Swap

Prop 26 Taxes, Regulatory Fee rules
2011 Redevelopment RIP Realignment
SB88 VLF shift to law enforcement grants
The State-Local Fiscal Relationship: A Rough Road

**Milestones in Municipal Finance History**

- **State Fiscal retrenchment, revenue & cost shifts**
- **Local revenue protection, constitutional limits**

**Key Events and Amendments**

- **1978**
  - Prop 13: Property Taxes
- **1979**
  - Prop 4: Spending Limits
- **1981-1983**
  - State Budget Troubles: City & County VLF Taken Many State Subventions Repealed
- **1986**
  - Prop 47: VLF must go to cities/counties
- **1990**
  - Prop 1A: Local $ protection
- **1992**
  - Prop 47: VLF must go to cities/counties
- **1996**
  - Prop 172: Public Safety Sales Tax
  - ERAF (Educational Revenue Augmentation Fund)
- **1999**
  - Prop 42: State Sales Tax to Transportation
  - VLF “CarTax” cut & backfill
- **2002**
  - Prop 57: Sales Tax “Triple Flip”
  - VLF-Property Tax Swap
- **2008-2010**
  - Redevelopment Property Tax Shifts
- **2009**
  - Prop 62: votes on taxes
- **2011**
  - Redevelopment RIF Realignment
  - SB 89 VLF shift to new enforcement grants

**Fiscal Road Concept Stolen from LAO**

**Are Incorporations and Annexations Extinct?**

Michael Coleman

Pernicious Effects of the VLF-Property Tax Swap of 2004
The VLF-Property Tax Swap of 2004

- **State General Fund**: $4.4 b
- **VLF Backfill**: $4.4 b
- **Schools**: $4.4 b

* in FY2004-05

The Lack of VLF Replacement Makes New Cities Fiscally Unviable

**City of Jurupa Valley General Fund**

- **VLF**
  - Declines to zero over 5 yrs
  - Swapped for PropTax in 2004

- **AB1602**
  - Special
  - Swapped for PropTax in 2004

- **VLF patch**
  - Assumed in incorp process

- **Actual** (after SB89 shift)

- **Other**
  - Franchise Fees
  - Licenses/Permits
  - SalesTax
  - Property Tax

If incorporated before 2004 swap, w/AB1602 VLF patch (assumed in incorp process), Actual (after SB89 shift)
The Lack of VLF Replacement Makes Many Annexations Fiscally Unviable

Diagnosing Municipal Financial Health
Introducing:
The League of California Cities’ California Municipal Financial Health Diagnostic

Michael Coleman
Bad Brew in Troubled Cities

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

Steering Away from the Precipice

Courageous, Collaborative, Competent

Elected Leaders
Management Staff
Stakeholders (Labor Leaders, Creditors)

or .... toxic relations, denial, fear/ineptitude.
Defining
Municipal Financial Health

Solvency
1. cash solvency - ability to meet immediate financial obligations; i.e. over next 30 or 60 days (accts payable, payroll).
2. budgetary solvency - ability to meet all financial obligations during a budget year.
3. long-run solvency – ability to meet all financial obligations into the future.
4. service-level solvency – ability to provide the desired level of services for the general health and welfare of the community.

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
Difficulties in Assessing Municipal Financial Health

- Published data are not complete or timely.
- Do we know what the numbers mean? Are they enough to draw conclusions?
- Comparisons are often false.
- Requires analysis, forecasting, context, legal
  - it’s not just an accounting or statistical exercise
  - history doesn’t tell you enough about the future

Our Approach

California Municipal Financial Health Diagnostic:
- Get to the primary indicators
  - useful & essential
  - Leave out extraneous / secondary
  - Add in overlooked & underappreciated factors
- Drill down to the real numbers
- Allow for nuance / clarification / differences
  - Reduce invalid conclusions and comparisons
- Constructive, thoughtful approach
The California Municipal Financial Health Diagnostic

1. The city has recurring general fund operating deficits.
2. General fund reserves are decreasing over multiple consecutive years.
3. General fund current liabilities (including short-term debt and accounts payable within 60 days) are increasing. Cash and short-term investments are decreasing.
4. General fund fixed costs, salaries and benefits are increasing over multiple years at a rate faster than operating revenue growth.
5. The general fund is subsidizing other enterprises or special funds.
6. The city council’s authority to make changes is constrained by charter, contract, or law. (e.g. bonding arbitration, minimum spending, minimum staffing or compensation formulas, etc.)
7. The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.
8. The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.
9. General fund pension liabilities, post-employment or other non-salary benefits have been repeatedly deferred or costs have not been determined, disclosed or actuarially funded.
10. General fund debt service payments have been “backloaded” into future years.
11. Ongoing general fund operating costs are being funded with temporary development revenues.
12. Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)
13. Public service levels are far below standards needed in this community.

For detailed indicators related to these points see the Financial Health Indicators.

Forecasting and Financial Planning

Michael Coleman
What is Long-Term Financial Planning?

Combines financial forecasting with financial strategizing to identify future challenges and opportunities, fiscal imbalances, and strategies to secure financial sustainability.

Why?
- Respond to a financial crisis
- Bring financial perspective to planning
- Stimulate long-term thinking
- Stimulate “big picture” thinking
- Address a particular issue or proposal
- Impose discipline
- Demonstrate good fiscal management

Steps in Long-Term Planning Process

- Review/Develop financial policies
- Analysis of fiscal environment
  - Current economic situation
  - Unfunded capital projects
  - Future liabilities
- Research/Trend analysis
- Document assumptions
Financial Planning  Sample Five-Year Forecast

$ Million

'14/15 '15/16 '16/17 '17/18 '18/19 19/20 20/21

Expenditures  Revenues  Fund Balance

Expenses  Non-Operating Costs  OPEB  Capital Imprv / Deferred Mtc

Less Favorable Revenue  Base Revenue  More Favorable Revenue

Financial Planning  Sample Five-Year Forecast

Expenses  Non-Operating Costs  OPEB  Capital Imprv / Deferred Mtc

Less Favorable Revenue  Base Revenue  More Favorable Revenue

Financial Planning  Sample Five-Year Forecast

Expenses  Non-Operating Costs  OPEB  Capital Imprv / Deferred Mtc

Less Favorable Revenue  Base Revenue  More Favorable Revenue
Top Tips for Elected Officials re Financial Management

1. Obtain key documents:
   - Annual Operating Budget
   - Capital Improvement Program
   - Comprehensive Annual Financial Report (CAFR)
   - Long Range Financial Plan
   - Interim Financial Reports
   - Investment Reports

2. Develop and Use Financial Policies.

3. Know the difference between a “one-time” solution versus a “defer” solution versus a “sustainable” solution
   - One-time solutions fix a current problem, but not an on-going one.
   - Deferrals “put-off” a problem by fixing a one-time problem but create as much or more added costs in future years.
   - A sustainable solution fixes an on-going budget problem now and into the future.

4. Ask hard questions about programs:
   1) What is the purpose of this program? Why is it needed?
   2) What are the specific intended outcomes of this program?
   3) What are the measurable objectives?
   4) What are the cost components: personnel, contracts, supplies, equipment, etc.?
   5) How will the costs of this program change in the future?
   6) What are the alternative service delivery approaches?
   7) Where will the money come from to pay for this?
   8) What are the consequences of not doing this program?

5. Avoid unsustainable budget practices including:
   - Exhaust the reserves
   - Freeze vacant positions
   - Make across the board cuts
   - Defer equipment purchases
   - Defer essential maintenance
   - Long-term formula driven spending
   - Defer pension or capital funding contributions
   - Eliminate training
   - Borrow from other funds
   - Ignore the small cuts
THE CALIFORNIA MUNICIPAL REVENUE SOURCES HANDBOOK

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Chapter 1

MILESTONES IN MUNICIPAL REVENUES: A Historical Perspective

The backdrop of any discussion of municipal revenues must be the state-local relationship and the provisions of the California Constitution that govern the relationship. This relationship has evolved over time, marked in recent decades by several landmark constitutional amendments. Consequently, today’s municipal revenue landscape is not the same as your grandmother’s or even your mother’s.

In California’s early years of statehood, local government authority was strictly controlled by the state government, and local affairs were the frequent subject of meddling by the Legislature. California governors and legislators often displayed a deep distrust of local affairs, while local officials sought more latitude in municipal policy and public services.
The 1879 California Constitution

Thirty years after California’s admission to the union, the second (and current) California Constitution was adopted by the Constitutional Convention during a turbulent period in the state’s political history. That adoption created, for the first time, substantial and meaningful home rule for California’s local governments. The 1879 Constitution included five provisions limiting the power of the Legislature to interfere with the affairs of cities and vested in cities extensive powers of self-government. This Constitution prohibited the state from imposing a tax for local purposes, but enabled the state to authorize local governments to impose them.

California City Revenues
FY2010–11 (excluding the City and County of San Francisco)

Over the next several decades, local taxation authority was expanded to general law cities. In 1903, in a case upholding the city of Los Angeles’ business license tax, the California Supreme Court stated unequivocally that local taxation is a municipal affair under article XI, §5 of the California Constitution. Later, in 1982, the Legislature conferred on general law cities by statute the authority to adopt any tax that could be adopted by a charter city.

A 1910 ballot measure known as the “Separation of Sources Act” made the property tax a local government revenue source and established the principle of separate revenue sources for state and local governments. The property tax was ideally suited to fund critical local general services such as law enforcement, jails, fire protection, parks, libraries, schools, hospitals and public health. This concept of the property tax as the largest, most durable and essential source of local government funding would stand for 68 years, until Proposition 13 drastically altered California local government finance.

In 1914, the California Constitution was amended to provide charter cities with the authority to “make and enforce laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in their several charters.” It established the power of charter cities to adopt their own laws with respect to municipal affairs, including flexibility in organizational and program design, latitude to regulate certain activities and the authority to determine spending levels and priorities. But local authority in municipal affairs remained subject to state pre-emption as to matters of statewide concern. In the event of a conflict between a charter city law and state law, the court must decide whether the state law prevails (because it is a matter of statewide concern) or the local law prevails (because it is a municipal affair). Thus, the dynamic interpretation of “matters of statewide concern” and “municipal affairs” controls the scope of home rule.

Source: CaliforniaCityFinance.com computations of data reported to California State Controller. Does not include data from the following cities that failed to report: Beaumont, Hawthorne, Imperial, La Habra, Lindsay, Placerville, Stockton, Taft, and Westmorland.
Statewide Concerns and Municipal Affairs

Although cities achieved greater local fiscal authority to determine service levels and levy local taxes and charges, state fiscal rules and constraints have often dominated. In 1935, the state pre-empted the local taxation of motor vehicles as real property and established a statewide uniform value-based tax on motor vehicles, known as the “motor vehicle in-lieu tax” or Vehicle License Fee (VLF), which it then allocated to cities and counties based on their share of county population.

In 1955, the Legislature passed the Bradley-Burns Uniform Sales and Use Tax Act, pre-empting then-existing local sales taxes and providing for a uniform, statewide system of sales taxation and collection. The Bradley-Burns Act authorized cities to adopt local sales and use tax rates up to 1 percent of taxable sales transacted in their jurisdictions to be administered and allocated by the state. The amounts of revenue remained intact, and the use of those revenues remained at local discretion.

These changes attempted to strike a balance between accommodating the needs of the modern industrial economy for uniform practices and procedures with California’s continuing commitment to meaningful local control of local government finance. They also attempted to address the important issues of taxpayer ease, uniformity and simplicity, but had the accompanying effect of centralizing fiscal authority with the Legislature and Governor while constraining local fiscal authority.

Through both Democratic and Republican administrations in the 1950s and 1960s, federal and state policy initiatives meant additional money and additional incentives, but also additional mandates for municipalities. In 1972, the Legislature responded to the vocal concern of local government over the costs of state mandates by passing SB 90 (Chapter 1406), requiring the reimbursement of costs to local agencies for state mandated programs. The following year, the Legislature required cost estimates of all legislation having a financial impact on local government. In 1979, mandated reimbursement, as required in SB 90, was added to Article XIII B of the California Constitution as a part of Proposition 4. The obligation to reimburse was further strengthened by Proposition 1A in 2004.

Property Tax Limits and Voter Approval of Special Taxes: Proposition 13 (1978)

In 1978, a simple majority of California voters approved Proposition 13, seeking property-taxpayer relief and uniformity, but with far-reaching consequences, some unintended. Proposition 13 reduced property tax revenues by more than half and effectively abolished any local control with regard to the property tax. Local governments still have wide latitude on the spending of the remaining revenues they receive, but the allocation of the tax is controlled by the state Legislature. Occasional proposals by the Legislative Analyst or individual policymakers to delegate more authority over property tax allocation to local governments tend to be met with resistance from local officials who fear the local conflicts and power struggles that would ensue in nearly any discussion of revenue reallocation.

Six Provisions of Proposition 13 Affecting Local Finance

1. One percent rate cap. Proposition 13 capped, with limited exceptions, property tax rates at 1 percent of full cash value at the time of acquisition. Prior to Proposition 13, local jurisdictions independently established their tax rates and the total property tax rate was the composite of the individual rates.

2. Assessment rollback. Proposition 13 rolled back property values as determined for tax purposes to their FY1975–76 level.

3. Reassessment upon change in ownership. Proposition 13 replaced the practice of annually reassessing property at full cash value with a system based on cost at acquisition. Under Proposition 13, property is assessed at market value for tax purposes only when it changes ownership. Subsequent annual values are limited to this “base year” amount plus an annual growth factor of 2 percent or CPI, whichever is less.

4. Responsibility for allocating property tax transferred to the state. Proposition 13 gave state lawmakers responsibility for allocating property tax revenues among local jurisdictions. Prior to Proposition 13, jurisdictions established their tax rates independently and their property tax revenues depended on the rate levied and the value of the property located within the boundaries of the jurisdiction.

5. Voter approval for special taxes. Proposition 13 requires two-thirds voter approval for taxes raised by local governments for a designated (“special”) purpose.

6. Taxes imposed by the Legislature require a two-thirds vote of the Legislature.
Prior to Proposition 13, effective total property tax rates varied, but averaged about 2.5 percent of market value. The 1 percent limitation and the rollback to FY1975–76 assessed values resulted in an immediate 57 percent reduction in property tax revenues statewide.

In FY1979–80, the Legislature used its authority to allocate property tax revenues to cushion the fiscal impact of Proposition 13 on local governments. In what is often called the “bailout,” the state was able to shift about $2.7 billion of annual ongoing financial resources to local governments in part because of the state’s $5 billion surplus (about 40 percent of annual revenues) and the $1 billion-plus annual revenue boost it received from higher personal income taxes due to lower taxpayer deductions for property taxes. As a result, city property tax losses from Proposition 13 were about 28 percent less than they might have been.

In addition to the bailout, the Legislature established a system for allocating property taxes. In what was intended as a permanent resolution to the issue of how to distribute significantly reduced property tax revenues, this solution, AB 8, reduced school shares of property tax revenues and gave cities counties and special districts greater shares. In return, the state assumed a larger financial responsibility for K-14 schools. The state also increased its share of costs for a number of social service and health programs operated by counties.

### Effects of Proposition 13
- Lowered tax burden for elderly and low-income homeowners (proportionate to income)
- Disparate treatment of similarly situated properties
- Disconnect between service costs and revenues deters balanced planning
- Local agency property tax revenues cut by nearly 60 percent
- Tax rates and shares out of sync with service demands
- Greater reliance on state General Fund for county and school spending
- Greater reliance in cities and counties on user fees and local taxes

### Trends in California Municipal Finance
- Decline in predictable discretionary funding for key services
- Sales tax revenues decreasing in service-oriented economy
- Population growth increasing service demands
- Public safety and homeland security costs increasing
- Infrastructure cracking under neglect
- New technologies leading to new infrastructure demands
- Environmental degradation (air and water pollution) requiring expensive mitigation
- Continued fragmentation of local finance among overlapping agencies
Despite these efforts to cushion its impact, Proposition 13 dealt a major blow to local fiscal autonomy. As the California Supreme Court noted in a 1991 decision upholding AB 8’s property tax apportionment system, Proposition 13 “prevents the preexisting taxing power” of cities. In a 1994 ruling upholding the state’s shift of property tax revenues from local governments (the infamous ERAF shift), the court noted that the taxing powers of local governments are “derived from the Constitution upon authorization by the Legislature.” The state was handed the authority to determine each local agency’s share within the 1 percent umbrella for all taxing agencies. There is no local authority to reallocate property tax revenue among local agencies (even those providing “city” services such as fire, parks or libraries). Thus, where once a community could devote more or less property tax revenue to fire services versus libraries versus schools, now all communities are constrained by taxing decisions made by leaders of a generation ago when California was a very different place socially, economically and politically.

By capping the property tax rate at 1 percent, Proposition 13 denied even local voters the authority to impose a higher property tax. The only exception to the 1 percent cap in Proposition 13 was for indebtedness approved prior to July 1, 1978. This effectively repealed the authority of a local agency to, with two-thirds voter approval, levy a rate to repay bonded indebtedness, authority which was established in the 1879 California Constitution. In 1986, California voters altered that aspect of Proposition 13 with the passage of Proposition 46, restoring the authority of local agencies, with two-thirds voter approval, approve a property tax rate override to repay bonded indebtedness issued for the acquisition or improvement of real property.

The Gann Limit

Following up on their success at limiting taxes, taxpayer advocates in 1979 convinced California voters to approve a measure aimed at limiting government spending. Conceived by tax activist Paul Gann, Proposition 4 set tax expenditure limits on the state and local governments based on the proceeds they received from taxes in FY1978–79, increasing with changes in population and inflation. In any year, an agency may not appropriate tax proceeds in excess of this limit unless an override, lasting a maximum of four years, is approved by a majority of voters. In 1990, voters approved Proposition 111, which, among other things, altered the spending limit, making the limit more accommodating of local revenue growth.

The 1980s: State Fiscal Retrenchment, Local Fiscal Innovation

In the years following Proposition 13, local governments faced substantially constrained revenues both from reduced property tax revenues but also from substantial reductions in state and federal aid. The state, after shifting resources to cushion the local impact of Proposition 13 found itself at times in fiscal trouble and repealed various state aid programs and even shifted local revenues to state coffers. Over the fiscal years 1981–82, 1982–83, and 1983–84, the state shifted more than $700 million of Vehicle License Fee (VLF) revenues from cities, revenue that had never before gone to the state General Fund.1 During these years, the state also repealed an assortment of local aid subventions including: the Highway Carriers Uniform Business Tax, Liquor License Fees, Financial Aid to Local Agencies (bank in-lieu subvention), and Business Inventory Exemption Reimbursements. Most of these payments had been put in place to reimburse locals for the state establishing a uniform statewide tax in lieu of local taxes or the state exempting some category of taxpayers.

Local governments responded by increasing various fees to recover full costs and eliminate subsidies. They sought out ways to raise existing taxes such as business licenses and hotel taxes. Many adopted new taxes such as utility user taxes, admission and parking taxes. With statutory authorization from the Legislature, they adopted new forms of assessments to provide needed funds for such things as streets, parks, lighting and landscaping.

The Courts Weaken Local Fiscal Authority

Meanwhile local control over fiscal matters continued to weaken. Proposition 13 had shifted the power to allocate what had been the number one source of discretionary local revenue, property taxes, to the state Legislature. Subsequent court decisions further weakened local fiscal autonomy. In 1991, the California Supreme Court gave
the state wider latitude to define a “matter of statewide concern” at the expense of home rule authority in fiscal affairs. In California Federal Savings & Loan v. Los Angeles, the court acknowledged that local taxation is generally a municipal affair, but declared the state’s system of taxation of financial institutions to be a matter of statewide concern. The court concluded that the conflicting charter city measure ceased to be a municipal affair and the Legislature was not prohibited by the Constitution from addressing the statewide dimensions of its own enactments. Assuming that financial institutions should be subject to a limited amount of taxation, the state decided that permitting local governments to receive a portion of these revenues through local taxation would interfere with the state’s ability to raise revenues for its own purposes.

■ Majority Vote for Taxes in General Law Cities and Counties: Proposition 62 (1986)
Reacting to the various forms of new local taxes and increases in fees in the wake of Proposition 13, the Howard Jarvis Taxpayers Association and other taxpayer groups responded with several follow-up initiatives. Proposition 62, a statutory initiative, passed in November 1986, restating the super-majority vote requirement for special taxes, imposing a majority vote requirement for general taxes, and prohibiting the imposition of taxes on the transfer of real estate. For nearly a decade, the applicability of Proposition 62 remained uncertain in the face of various court cases. Most provisions were eventually superseded by Proposition 218 in 1996.

■ E.R.A.F.: Educational Revenue Augmentation Funds
The most dramatic example of the shift of power from local governments to the state is the Legislature’s use of local property tax to balance the state’s budget troubles beginning in the early 1990s. Despite major changes in local priorities and needs, the apportionment formulas for property taxes had remained largely unchanged since AB 8. In 1978, neither the pundits nor the authors of Proposition 13 envisioned the state Legislature using the power to allocate local property tax revenue given to it by Proposition 13 as a means to take local tax revenues to meet its own financial needs. But in 1992, facing a serious state General Fund deficit, the state Legislature turned to these powers as a remedy.

To meet its obligations to fund education at specified levels under the Proposition 98 educational funding formulas, the state enacted legislation that shifted partial financial responsibility for funding education to local government (cities, counties and special districts). The state did this by instructing county auditors to shift the allocation of local property tax revenues from local government to “educational revenue augmentation funds” (ERAFs), directing that specified amounts of city, county and other local agency property taxes be deposited into these funds to support schools.

In FY2011–12, the annual impact of the ERAF shift was a shortstopping of some $7.3 billion from cities, counties, special districts and the citizens those entities serve. Counties have borne some 74 percent of this shift; cities have borne 16 percent.

The state has provided some funding to local governments that it is considered by most to be mitigation of ERAF. However, the vast majority of these funds are earmarked for particular purposes. Moreover, a relatively small portion of these funds has gone to cities. In 1992, California voters approved Proposition 172, which provided sales tax funding for police, fire and other public safety programs. See Section 6.05 of Chapter Six. In FY2011–12, Proposition 172 funds provided only $2.5 billion annually to local government, leaving a $4.8 billion net ERAF gap. Considering all state subventions that the Legislative Analyst defines as “ERAF mitigation,” the net ERAF impact on cities was nearly $800 Million in FY2011–12.²

As a part of the budget agreement that put Proposition 1A of 2004 on the ballot to protect city revenues from additional shifts and state takeaways, cities, counties and special districts agreed to contribute an additional $1.3 billion per year in FY2004–05 and FY2005–06. Although these ERAF III shifts ended in FY2006–07, the original ongoing shifts that began in FY1992–94 have not been reduced.³
Chapter 1: Milestones in Municipal Revenues

### Voting on Taxes, Assessments and Property Related Fees: Proposition 218 (1996)
In November, 1996, California voters approved Proposition 218, expanding restrictions on local government revenue-raising by adding Article XIIIIC and XIIIID to the California Constitution. The measure allows voters to repeal or reduce taxes, assessments, fees, and charges through the initiative process; reiterates the requirement for voter approval for both “special taxes” and “general taxes;” and imposes procedural and substantive limitations on benefit assessments imposed on real property and on certain types of fees.

Proposition 218:
- Establishes a clear constitutional standard distinguishing locally imposed general taxes from special taxes and imposing a majority voter requirement for general taxes (which had already existed for general law cities under Proposition 62) and a supermajority requirement for special taxes (which had already existed under Proposition 13);4
- Provides citizens with the power to repeal taxes, assessments, fees and charges that are subject to Proposition 218;
- Establishes a formal balloting procedure for the adoption of benefit assessments imposed on property;
- Requires a distinction between special benefits and general benefits with regard to assessments and prohibits the funding of general benefits from property assessments;
- Requires the assessment of public property within an assessment district;
- Places the burden of proof for demonstrating special benefit on the local agency imposing the property assessment; and
- Establishes a new category of fees called “property-related fees” and requires new approval procedures and substantive provisions for those fees.

Reacting to continued state shifts of local property tax revenues, the deterioration of local control of fiscal matters and the substantial limitations imposed by Proposition 218, the League of California Cities, the California State Association of Counties (CSAC) and the California Special Districts Association (CSDA) crafted a local revenue protection initiative and garnered enough signatures to qualify the proposition for the November 2004 ballot. Governor Arnold Schwarzenegger, who had recently taken office in the November 2005 recall of Gray Davis, immediately signaled his opposition to the measure but a willingness to support a new mutually crafted local revenue protection measure as a part of a larger state-local fiscal restructuring package to include local contributions to assist the state budget problem over two years.

With the active involvement of Legislative leadership, the Schwarzenegger Administration, the League, CSAC and CSDA worked on an alternative to Proposition 65 that became Proposition 1A. The Legislature placed the measure on the November ballot. As part of the 2004 state-local agreement, the state shifted $1.3 billion of local property tax revenues in FY2004–05 and again in FY2005–06 (the so-called ERAF III). In addition, the state General Fund backfill to cities and counties for state cuts of the Vehicle License Fee was eliminated and instead cities and counties were given additional annual property tax revenues See Section 6.01 of Chapter Six. Finally, local government associations agreed to abandon support of Proposition 65 and the Governor agreed to actively support Proposition 1A.

In November 2004, the voters of California approved Proposition 1A with an unprecedented 84 percent of the yes vote, Constitutionally protecting major city revenues from additional shifts to the state and strengthening local government’s ability to get reimbursement for unfunded mandates. In 2010, voters passed another measure to protect local government finances. Proposition 22 prohibits the state
from borrowing, delaying or taking certain funds allocated to local governments and eliminated a provision of Proposition 1A allowing the state to borrow a limited amount of property tax revenue under certain conditions. Together, these measures:

- Strengthen prohibitions against unfunded state mandates by requiring the state to suspend state mandates in any year the Legislature does not fully fund those laws.\(^5\)
- Expands the definition of state mandate to include transfer of responsibility of a program for which the state previously had full or partial responsibility.
- Prohibit the state from:
  - Reducing the local Bradley-Burns Uniform Sales and Use Tax rate or altering its method of allocation. Exception to comply with federal law or an interstate compact;
  - Decreasing VLF revenue from the 0.65 percent rate without providing replacement funding to cities and counties;
  - Shifting property taxes from cities, counties or special districts;
  - Failing to reimburse to cities and counties for the 0.25 percent local sales tax shifted under the triple flip; and
  - Borrowing, delaying or taking motor vehicle fuel tax allocations, gasoline sales tax allocations, public transportation account funds or redevelopment agency property tax increment.

**Sales and Use Tax Rate and Allocation Method.** Generally revenue from the 1 percent Bradley-Burns Local Sales and Use Tax is allocated to the city in which the sale occurs, or, if in an unincorporated area, the county. Proposition 1A prohibits the Legislature from reducing the local sales tax rate, or changing the method of allocation of local sales tax revenues. Proposition 1A permits the Legislature to change the method of allocation in order to comply with federal law or an interstate compact.

**Local Transactions and Use Tax Authority.** Proposition 1A prohibits the state from restricting the authority of a local government to impose a transactions and use tax pursuant to Revenue and Taxation code Section 7251 or altering the method of allocation of these tax revenues.

**Local Sales Tax Reduction Under the Proposition 57 Triple Flip.** In March 2004, California voters approved Proposition 57, the California Economic Recovery Bond Act. Legislative provisions implementing Proposition 57 provide for a swapping of 0.25 cent to be used by the state to repay the bonds effective July 1, 2004. The so called “triple flip” comprises:

1. Reducing the Bradley-Burns Local Sales and Use Tax Rate by 0.25 percent and 0.25 percent to the state’s sales tax rate to fund fiscal recovery bond repayment;
2. Repayment to cities and counties with additional local property tax previously allocated to local schools; and
3. Repayment to local schools with state General Fund.

Proposition 1A prohibits the Legislature from extending this reduction in local authority to impose the full Bradley-Burns Sales and use tax rate beyond the period necessary to repay the Proposition 57 bonds. In addition, it constitutionally protects the reimbursement to cities and counties under the triple flip. The Proposition 57 Sales Tax Triple Flip ends when the economic recovery bonds are fully paid, which is expected in 2016.
Vehicle License Fee. Proposition 1A requires the Legislature to provide replacement revenue to cities and counties if it reduces the VLF rate below 0.65 percent. California Constitution Article XI §15 requires that VLF revenue be allocated to cities and counties. The state may charge for administrative costs (DMV, Controller) and the Legislature retains the power to change state law allocating the VLF among cities and counties. See Section 6.01 for more on the VLF.

Property Tax. Proposition 1A prohibits the Legislature from reducing the share of property tax revenues going to the cities, county and special districts in any county, and shifting those shares to the schools or any other non-local government function. However, the Legislature may alter the allocation of property taxes among cities, counties and special districts within a county with two-thirds approval in each house. Proposition 1A also contained provisions allowing the state to borrow up to 8 percent of city, county and special district property tax revenues in one year under specific conditions. The Legislature invoked this option as a part of the 2009 Budget Act. The loan, used to finance annual operations in FY2009–10 was fully repaid with interest according to law in June 2013. Proposition 22 (2010) prevented this from occurring again by eliminating this property tax loan option. See Section 2.01 for more on the property tax.

Proposition 1A did not provide local governments with any new revenue nor reduce or alter the ERAF I and II shifts.

Refining the Definition of “Tax”: Proposition 26 (2010)
In November, 2010, California voters passed Proposition 26, which added a definition of “tax” to the California Constitution. The new provisions state that a government-imposed charge, levy or exaction of any kind is a tax unless it falls into one of seven express exceptions. The effect of the measure was to particularly tighten the definition of regulatory fees and certain assessments.

The Great Recession and the Dissolution of Redevelopment
Despite the substantial protections provided to local governments by Propositions 1A and 22, threats to local finances continued. Local budgets struggled from the impacts of the great recession, mounting costs of pensions and unfunded public employee retiree health benefits. Three large cities, unable to balance their budgets without violating legal payment obligations and unable to garner sufficient concessions from labor and other creditors, entered into bankruptcy proceedings. Others cut public services to unprecedented low levels.

Meanwhile, the State Budget Act of 2011 included a major realignment of corrections and law enforcement programs to counties with potential crime impacts in local communities. Counties sought assurances that adequate funding would also be provided. In late “gut-and-amend” legislation, all remaining city VLF funds were shifted to pay for state law enforcement grants to locals that had previously been funded by the state general fund. This wiped out allocations to new cities and annexations that had compensated for a flaw in the 2004 VLF-Property Tax swap.

With the 2011 Budget Act, Governor Jerry Brown also signed into law two bills aimed at extracting revenues from Redevelopment Agencies help remedy the State’s ongoing budget deficit. The legislation provided that each redevelopment agency must agree to make substantial annual payments to aid the state or dissolve as of October 1, 2011.

On December 29, 2011, the California Supreme Court upheld the constitutionality of dissolution of redevelopment while striking down the payment scheme. Approximately 400 redevelopment agencies dissolved on February 1, 2012, with the assets and liabilities transferred to Successor Agencies and Successor Housing Agencies.
But in November 2012, the state’s fiscal woes took a major turn for the better. Following substantial cuts in state programs, voters approved Proposition 30 temporarily increasing state sales and income tax rates. The state budget was more easily balanced and the Legislature began fully paying down over $30 billion in accumulated budgetary debt.

### The Road Ahead for California Local Finance

Local revenues are now more stable and protected than ever before. Substantial constitutional limits have been placed on the Legislature’s ability to take or shift local revenues. The state’s fiscal condition has improved thanks to major program reductions in many areas, an infusion of temporary taxes that will pay off a mountain of accumulated budgetary debt, and a gradually improving economy.

But major risks and uncertainties persist. While Proposition 30 has seemingly provided a reprieve for as many as seven years, the state continues to struggle with the funding of corrections, health care, education, public employee benefits and major infrastructure. Substantial unbudgeted liabilities loom in teacher and state employee retirement systems. The state’s long term budgetary balance remains cloudy.

The finances of local agencies face similar challenges. Many local agencies are grappling with major unbudgeted liabilities in the areas of post employment benefits (especially healthcare) — pension plan cost increases due to lower investment earnings, greater longevity and unsustainable benefit levels previously granted especially in the areas of police and fire. Local public works systems face major improvement needs in many areas.

Threats to the ability of communities to finance local services through locally levied taxes and other sources of revenue are likely to continue. Local governments will continue to grapple with evolving local public service needs and a local revenue portfolio that fluctuates with economic and socio/technical changes. Rather than make necessary effective reforms, the Legislature usually chooses expedient, ineffective “band-aid” remedies to serious local finance issues.

While local revenues are returning on the heels of a slowly recovering economy, public employee pensions and retiree health care costs are outpacing this revenue growth. The specter of more municipal insolvencies or bankruptcies persists. Municipal fiscal sustainability is a critical issue.

As always, skilled finance and management is essential to move forward through this. This handbook is designed to help you find your way.

### For More Information:


### Endnotes.

1. Subsequently, in 1986, the voters approved Proposition 47 which requires that VLF revenues be allocated to local governments.
2. Cities not including the city and county of San Francisco.
3. Subsequent to the transfer of these funds, they are reallocated within each county back to cities and counties to compensate for the state’s repeal of the VLF backfill in 2004 and the temporary one-quarter cent sales tax shift to support the state deficit reduction bonds. However, this mechanism does not alter the existence or real effect of the ERAF I and II shifts.
4. In 1982, the state Supreme Court decided City and County of San Francisco v. Farrell, which defined the term special tax as any tax earmarked for a specific purpose. Under Proposition 13, a special tax requires the approval of two-thirds of voters.
5. Proposition 1A does not apply to mandates affecting local schools or mandates related to employee relations and collective bargaining.
A tax is a monetary imposition by a government on persons or property for the purpose of raising revenue to support the purposes of the government. In contrast to an assessment or a fee, a tax need not be levied in proportion to specific benefit to a person or property. Fees or charges will be considered taxes to the extent they exceed the reasonable cost of the service, commodity or facility for which they are imposed.

California cities do not have an inherent power to tax. Charter cities are given the power to tax pursuant to Article XI, §5 of the California Constitution and may levy taxes for municipal purposes without specific authorization from the Legislature. As authorized in state statute, a general law city, with certain exceptions, may levy any tax that a charter city may levy. State law may set certain limits and procedures and may exempt certain activities from taxes levied by general law cities. These laws apply to charter cities in matters that the courts have determined are of statewide concern.
### General and Special Taxes

The passage of Proposition 13 in 1978 created a distinction between “general” and “special” taxes. Proposition 218, in 1996, further defined and established procedures for general taxes.³

- A general tax is a tax imposed for general governmental purposes, the proceeds of which are deposited into the General Fund. A majority vote of the electorate (those voting on the measure) is required to impose, extend or increase any general tax.

- An election on a general tax must be consolidated with a regularly scheduled general election of city council members, except in cases of emergency declared by a unanimous vote of the city council.²

- Single-purpose special districts (“special purpose districts”) may not impose general taxes.

A special tax is a tax that is collected and earmarked for a specific purpose and deposited either into a separate account or the General Fund. A two-thirds vote of the electorate is required to impose, extend or increase any special tax.

### Proposition 26: Defining a Tax By What it is Not

California voters approved Proposition 26 in November, 2010, placing new rules into the California Constitution stating that a government-imposed charge, levy or exaction of any kind is a tax unless it falls into one of seven express exceptions.

1. **A charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege.**

   **Specific Benefit Exception** examples include fees for planning permits, restricted neighborhood parking permits, and entertainment and street closure permits.

2. **A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.**

   **Government Service or Product Exception** examples include user fees for parks and recreation classes, utilities (other than those covered under #7), public records copying fees, DUI emergency response fees, emergency medical and ambulance transport service fees.

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<td>A general tax election must be consolidated with a regularly scheduled general election of members of the governing body, unless an emergency is declared by unanimous vote (among those present) of the governing body.</td>
<td>Special tax funds must be deposited in a separate account. The taxing agency must publish an annual report including: 1) the tax rate; 2) the amounts of revenues collected and expended and 3) the status of any project funded by the special tax.</td>
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Chapter 2: Taxes

3. A charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.

Permits and Inspections Exception examples include health and safety permits, building licenses, police background checks, pet licenses, bicycle licenses and permits for regulated commercial activities (such as massage establishments, card rooms, taxicabs and tow-truck operators).

For exceptions 1 through 3, the fee imposed must not exceed the agency’s reasonable costs.

4. A charge imposed for entrance to or use of local government property or the purchase rental or lease of local government property.

Local Government Property Exception examples include facility room rentals; equipment rentals; park, museum and zoo entrance fees, golf greens fees, on and off-street parking, and tolls.

5. A fine, penalty, or other monetary charge imposed by the judicial branch of government or a local government as a result of a violation of law, including late payment fees, fees imposed under administrative citation ordinances, parking violations, etc.

Penalty for Illegal Activity Exception examples include parking fines, code enforcement fees and penalties, late payment fees, interest charges and other charges for violation of the law.

6. A charge imposed as a condition of property development.

Property Development Exception examples planning fees, building permit fees, construction and grading permits, development impact fees, fees imposed by California Environmental Quality Act mitigation requirements, and Quimby Act and park mitigation fees.

7. Assessments and property related fees imposed in accordance with the provisions of Article XIII D. (Proposition 218).

Proposition 218 Exception examples include assessments on real property for special benefit conferred, fees imposed upon a parcel or a person as an incident of property ownership, and fees for a property related service such as many retail water and sewer fees.

When is a Tax Imposed, Increased or Extended?

Under Proposition 218, no local government may impose, extend or increase any general tax until such tax is submitted to the electorate and approved.6

A tax is “imposed” when the local tax ordinance is adopted, and each time a tax is collected.7 “Extend” means a decision by an agency to extend the stated effective period for the tax or fee or charge, including amendment or removal of a sunset provision or expiration date.8

A tax is “increased” when an agency either 1) increases the rate used to calculate the tax; or 2) revises the methodology by which the tax is calculated if that revision results in an increased amount being levied on any person or parcel.9 A tax is not “increased” if 1) it is imposed at a rate no higher than the maximum rate previously approved, or 2) it is adjusted in accordance with a schedule of adjustments, including a clearly defined formula for inflation that was adopted prior to November 6, 1996.10 However, a tax which is calculated by using a percentage is “increased” when it is adjusted for inflation even if the voters approve the tax.11
Additional Aspects of Municipal Taxation in California

- A local tax can be reduced or repealed by initiative unless it supports bonded debt. Many taxes can be imposed or increased by initiative as well.
- Certain types of local taxes are specifically pre-empted by state law. These include taxes on: cigarettes, alcohol and personal income.
- State law provides various additional procedural requirements for the enactment of some taxes depending on the type of tax.
- If a local agency wants to collect a previously approved tax at a rate lower than was authorized by the voters, the agency should make it very clear in its official actions that the rate is being “suspended” for a certain period of time and not being permanently lowered. An agency that collects a previously approved tax at a rate lower than was authorized by the voters without a statement clarifying the intent and purpose of the suspension may trigger a Proposition 218 vote requirement when it begins collecting the tax at the previously approved rate.

For More Information:

Applying Proposition 26

If you have a charge imposed by a government agency...

Was it authorized prior to November 3, 2010 (the effective date of Prop. 26)?

- YES
  - The fee may be implemented until it is “increased” or “extended” by legislative action.

- NO
  - Was the fee or charge “imposed” (some government force or authority obliges the payor to pay the fee)?
    - YES
      - Under Proposition 26, it is NOT a tax
    - NO
      - DOES one of the seven exceptions apply?
        - 1. The Special Benefit or Privilege Exception. Fees imposed that provide a special benefit to the person paying the fee or directly grants the person some privilege. See Section 4.01.
        - 2. The Government Service or Product Exception. Fees imposed for a specific government service or product provided directly to the person paying the fee. See Section 4.01.
        - 3. The Regulatory Program Exception. Fees to cover reasonable regulatory costs of issuing licenses and permits, performing investigations, inspections and audits, and enforcement. See Section 4.04.
        - 4. The Local Government Property Exception. Fees for the use of or entrance to local government property. See Section 5.06.
        - 5. The Fines and Penalties Exception. Fines and penalties imposed for violations of the law. See Section 5.05.
        - 6. The Property Development Exception. Fees imposed as a condition of property development. See Section 4.03.
        - 7. The Proposition 218 Exception. Property assessments and property-related fees subject to the approval requirements of Proposition 218. See Section 4.02 (property related fees) or Section 3.01 (Assessments on Property)

It is a “tax.”
Voter approval is required. See Chapter 2.
Benefit assessments (also called “special assessments”) are levied to pay for specifically identified public improvements or services that specially benefit the properties or businesses subject to the assessment.

A number of state laws permit the imposition of assessments for various purposes. General law cities may impose an assessment under one or more of these laws, following the procedures and limitations set forth in that law. Charter cites may also use state laws, but often choose to enact and proceed under their own assessment laws. Local assessment laws adopted by charter cities are typically drafted to incorporate one or more of the statewide laws, but may include revisions to the incorporated law streamlining procedures or permitting the financing of additional improvements or services. Generally, such local laws must comply with California Constitution Article XVI, Section 19.
Assessments Versus Fees and Taxes

The key distinction between a benefit assessment and other types of revenue measures, such as fees and taxes, is that an assessment is based upon the special benefit that a property (or business) will derive from the improvement or service provided by the assessment.

Benefit assessments may also be distinguished from “nuisance abatement assessments,” which are legally a form of regulatory fee (see Chapter Four, Section 4.04) or other “assessments” which are in the nature of a fine or penalty (see Chapter Five, Section 5.05).

Proposition 218

Proposition 218 (California Constitution Article XIIIID), passed by the voters on November 5, 1996, affects most special assessments imposed since the passage of the act that are imposed on real property, in five principal ways:

1. Subjects assessments to repeal or reduction by initiative unless they have been bonded, triggering the protection of the federal Constitutional contract clause;

2. Establishes procedural requirements for the levy of assessments, including the requirement for majority property owner approval by a mail ballot process;

3. Requires the local agency to separate the general benefits from the special benefits conferred on a parcel, and to only assess for the special benefit;

4. Forbids the use of assessments on private property to fund the portion of the special benefit of a project or program which accrues to public agency property and can be argued to limit the general rule of intergovernmental tax immunity to allow assessment of government property; and

5. Shifts the burden of proof in legal actions to contest the validity of an assessment to the assessing government.

Use of Initiatives to Reduce or Repeal Assessments

Proposition 218 provides that the initiative power may be used to reduce or repeal any local tax, assessment, fee or charge.2

Benefit Assessment Revenues

California Cities (excluding the city/county of San Francisco)

Source: CaliforniaCityFinance.com computations from data from California State Controller (revenues), California State Dept of Finance (population, CPI)
Fees comprise a broad category of locally imposed revenues generally intended to recover all or a portion of a government’s costs for providing a service or access to public property, or for mitigating the impacts of the fee payer’s activities on the community. A fee may not exceed the estimated reasonable cost of providing the service or facility for which the fee is charged. Fees are sometimes called charges and are often called rates in the context of utility services. The term “fee” is used in this chapter.

The list of fees is extensive, and includes: user fees, such as park admission fees or fees charged for recreation programs; enterprise service fees, such as water, sewer or refuse collection fees; regulatory fees, such as plan check fees, inspection fees, permit application fees and other fees imposed on regulated activities; and mitigation fees, such as those imposed to offset impacts resulting from new development. Fees in one category may have attributes of fees in another. Certain fees imposed for a property-related service are subject to specific procedural and substantive requirements of Proposition 218.

A fee may not exceed the estimated reasonable cost of providing the service or facility for which the fee is charged.

Thanks to Betsy Strauss, Dan Hentschke and Michael Colantuono for their contributions to this chapter.
Chapter 4: Fees, Charges and Rates

Generally speaking there are two broad categories of fees and charges: user fees and regulatory fees. User fees are charged for the use of a public service or program such as fees charged for recreation programs or public document retrieval. User fees for property-related services are referred to as property-related fees.

Regulatory fees are charged either to pay for the cost of a government program which regulates the activities of the fee payers or to mitigate the impact of the fee payer’s activities on the community. A development impact fee is a common regulatory fee which imposes a charge to defray the cost of the development on a public facility such as streets or schools.

All user fees and regulatory fees are subject to the same limitation: The amount of the fee may not exceed the “estimated reasonable cost” of the providing the service, facility or program or (as in the case of regulatory fees) of mitigating the impact of the fee payer’s activity. “Estimated reasonable cost” may include reasonable administrative expenses and overhead. Revenues collected in excess of the service cost may be categorized as “taxes,” which require voter approval.

Regulatory fees must be reasonable, fair and equitable in nature and proportionately representative of the costs incurred by the regulatory agency for administrative enforcement and related adjudicatory activities.

The distinction between fees and taxes is frequently blurred, especially in the media and common discussion, but generally fees are imposed in return for a benefit conferred or privilege granted, while taxes are simply intended to collect revenue (see Chapter Two for taxes). The legal distinction is important, however, because adoption procedures and other rules vary depending on the proper classification of the revenue. Fees must also be distinguished from assessments, which are levied strictly based on “special benefit” conferred, and fines, which are collected because of a violation of a law (see Chapter Three for assessments).

Although they are often called “fees,” charges for the use of public facilities such as for off-street parking, marina berth rates and facility rental are paid for the use of public property and are more similar to rent. Fees for the use of public property are considered rent, and are generally set at the discretion of the public agency and are not subject to the requirement that revenues not exceed the costs of service. See Chapter Five, Section 5.06.

Proposition 26: Defining a Tax By What it is Not

Proposition 26, approved by the voters on November 2, 2010, provides further distinctions among these categories of revenues. The constitutional measure stipulates that a government-imposed charge, levy or exaction of any kind is a tax unless it falls into one of seven express exceptions.

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Fees enacted prior to November 3, 2010 are unaffected by Proposition 26 until they are extended or increased. That is, even if a fee enacted prior to November 3, 2010 does not fit within any of the tax exceptions under Proposition 26, it may nonetheless be valid provided that the legislation authorizing it is not amended so as to extend or increase the fee.

Laws governing fees vary based on the particular type of fee imposed. It is extremely important to discuss any new fee, or increase or adjustment of any existing fee with the city attorney or agency counsel.

In this manual, the categories of revenues are organized as follows:

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For More Information:
Proposition 26 Implementation Guide, 2011, League of California Cities,
www.cacities.org/Prop26Guide.
Admissions Tax
Tax is imposed on the consumer for the privilege of attending a show, performance, display or exhibition. See Chapter 2, Section 2.08.

Advance Refunding
When restructuring or retiring outstanding bonds, the refunding is an “advance refunding” if the outstanding bonds will not be paid off until later than 90 days after sufficient funds have been deposited with a trustee. Generally, federal law limits advance refundings to one occurrence. See also “current refunding.”

Ad Valorem Tax
A tax assessed based on the dollar value of an item or activity. Typical examples are property and sales taxes. Ad valorem taxes contrast with per-unit taxes, such as alcoholic beverage and cigarette taxes, which are assessed at a fixed dollar per unit purchased.

Appropriation
A legal authorization granted by the city council to expend monies, and incur obligations for specific purposes.

Appropriations Limit
A maximum amount of revenues that may be appropriated by a government agency determined under California Constitution Article XIIIB and implementing legislation. See Chapter 10.

Appropriations Subject to Limit
Revenues defined as “proceeds of taxes” under California Constitution Article XIIIB and implementing legislation. See Chapter 10.

Arbitrage
A technique used to take advantage of price differences in separate markets. This is accomplished by either selling debt instruments at a low interest rate and investing the proceeds at a higher rate or by purchasing securities, negotiable instruments or currencies in one market for immediate sale in another market at a better price.

Assessed Valuation
The value of real property for the purpose of taxation. See page 14, Section 2.01.

Assessment District
Not a separate governmental entity, but rather a defined area of land which will be benefited by the acquisition, construction or maintenance of a public improvement.

BANs
See bond anticipation notes.

Benefit Assessment
Charges levied on parcels to pay for public improvements or services provided within a pre-determined district or area according to the benefit the parcel receives from the improvement or services.

Benefit Assessment Act of 1982
The 1982 Act lets cities, counties and special districts finance a variety of improvements. The Act requires majority voter approval if the proposed assessment area has 12 or more registered voters. If less than 12, the owners of at least 60 percent of the land in the assessment area must give written consent to the assessment.

Benefit Assessment Bonds
Bonds levied by cities, counties and special districts to acquire or construct public improvements which convey a special benefit to a defined group of properties.

Block Grant
Federal grant allocated according to pre-determined formulas and for use within a pre-approved broad functional area such as the CDBG (Community Development Block Grant).

Bond Anticipation Notes (BANs)
BANs are short-term borrowings by a public entity appropriate to obtain financing for a project for which bonds are authorized but not yet issued. BANs permit the issuance of debt in increments as work on a project progresses and before some or all of the bond proceeds are available.

Bond Resolution
A legal order or contract by a governmental unit to authorize a bond issue. A bond resolution carefully details the rights of the bondholders and the obligations of the issuer.

Bonds
A certificate of debt issued by an entity, guaranteeing payment of the original investment, plus interest, by a specified future date.

Broughton Act
Restricts city collection of franchise payments to 2 percent of the franchise’s gross annual receipts arising from use of the franchise.

Business Improvement District
A public-private partnership in which businesses in a defined area pay special taxes, fees and/or assessments to fund public facility improvements and programs in the area. See section 3.02.

Business License Tax
A type of excise tax imposed on businesses for the privilege of conducting business within the city. The tax is most commonly based on gross receipts or levied at a flat rate.

California State Board of Equalization (BOE)
California state agency responsible for the collection and administration of the state’s sales and use, alcohol, tobacco, and other taxes. In addition, the BOE determines the assessed value of certain properties and oversees property tax assessment practices of county assessors.

California State Controller
The Controller is the chief fiscal officer of the state and is elected every four years. The Controller is responsible to: account and disburse all state funds; determine the legality and accuracy of claims against the state; pay the state’s bills; audit and process all personnel and state payroll transactions; audit various state and local government programs; administer the Unclaimed Property Law; and inform the public of financial transactions of city, county and district governments.

Capital Improvement Program (CIP)
Annual appropriations in the city’s budget for capital improvement projects such as street or park improvements, building construction, and various kinds of major facility maintenance.
Glossary

Capital Outlay
Expenditures which result in the acquisition of, or addition to fixed assets.

Categorical Grant
Grant typically allocated either to qualifying applicants according to a formula or to applicants competing for project grants through an application process. Categorical grants are the most common form of federal aid.

Certificates of Participation (C.O.P.)
Debt instrument, commonly called C.O.P., that provides long-term financing through a lease (with an option to purchase) or through an installment agreement.

Charter City
Charter cities have authority over “municipal affairs,” trumping state law governing the same topic. In contrast, general law city is a city that has not adopted a charter and is therefore bound by the state’s general laws, even with respect to municipal affairs.

Citizens Option for Public Safety (COPS)
A state subvention for local law enforcement initiated in 1996. See section 6.04.

Community Facilities District (CFD)
See Mello-Roos Community Facilities District.

Community Rehabilitation District Law of 1985
Allows cities and counties to fund the renovation and repair (but not maintenance) of an existing structure.

Concessions
Revenues received from concessionaires for privilege of operating a concession on city property.

Construction/Development Tax
Excise tax imposed on the privilege or activity of development and/or the availability or use of municipal services. See section 2.10.

Consumer price Index (CPI)
A statistical description of price levels provided by the U. S. Department of Labor. The change in this index from year to year is used to measure the cost of living and economic inflation.

COPS
See Citizens Option for Public Safety.

C.O.P.
See certificates of participation.

County Assessor
An elected official whose main duty is to set values on real property for the purpose of taxation within the county. The Assessor is responsible for the creation and maintenance of assessor parcels from final subdivisions, parcel maps, lot line adjustments, record of survey, deeds and miscellaneous documents.

County Auditor-Controller
The chief accounting officer of the county established to provide various accounting and property tax administration services to the county and other local governments within the county. The Auditor Controller is responsible for budget control, disbursements and receipts, financial reporting, and for audits of certain agencies within the county. Auditor-Controllers are nonpartisan elected officials serving four year terms, except in four counties with appointed officers: San Francisco, Santa Clara, Los Angeles, and San Diego.

County Treasurer-Tax Collector
Administers the billing, collection, and reporting of property tax revenues and conducts Tax Defaulted Property Sales for real property tax delinquencies remaining after five years. Treasurer-Tax Collectors are nonpartisan elected officials serving four-year terms except in three counties with appointed officers: Los Angeles, Sacramento, and Santa Clara.

Countywide/Statewide Pools
A system used to allocate local sales and use tax payments that cannot be identified with a specific place of sale or use in California. Local tax reported to the pools is distributed to the local jurisdictions in proportion to taxable sales.

Current Refunding
When restructuring or retiring outstanding bonds, if bonds are paid off within 90 days of depositing either cash on hand or refunding bond proceeds, the refunding is a “current refunding.” See also “advance refunding.”

Debt Financing
Issuance of bonds and other debt instruments to finance municipal improvements and services.

Debt Instrument
Written pledge to repay debt such as bills, notes and bonds.

Debt Service
Payment of principal and interest on long-term indebtedness.

Dedication
The donation “dedication” of certain lands (or money) to specific public uses as a requirement for the approval of a development project. The dedications are typically justified as an offset to the future impact the development will have on existing infrastructure. Also called an “exaction.” See section 4.03.

Development Impact Fees
Fees placed on the development of land or conditions required for the approval of a development project such as the donation “dedication” or “exaction” of certain lands (or money) to specific public uses. The fees are typically justified as an offset to the future impact that development will have on existing infrastructure. See section 4.03.

D.I.V.C.A.
“The Digital Infrastructure and Video Competition Act of 2006” [AB 2987 (Nunez/Levine)] effectively replaced locally issued franchise agreements for video service with a system of state-issued franchises subject to certain limited locally imposed conditions and requiring franchise fees to be paid to local agencies where services are provided. See section 5.01.

Documentary Transfer Tax
Tax imposed on documents recorded in the transfer of ownership in real estate as distinguished from a Real Property Transfer Tax which may only be imposed by charter cities. See section 2.07.

Encumbrance
An anticipated expenditure committed for the payment of goods and services not yet received or paid for.
**Earmarked funds**
Funds that have been tagged or “earmarked” for a specific purpose.

**ERAF: Educational Revenue Augmentation Fund**
Accounts established by the state Legislature to receive shifts of property tax revenues from cities, counties, special districts, and redevelopment agencies. The additional ERAF property tax revenues to schools enable the state general fund to reduce support from the state general fund, thereby saving the state billions of dollars annually.

**Exactions**
See dedications.

**Excise Tax**
Tax placed on a person for a voluntary act, making the tax avoidable. Includes sales and use tax, business license tax, transient occupancy tax, utility users tax, etc. Phrase “excise tax” is most commonly used to refer to a parcel tax.

**Exemption**
The exclusion from the tax base of certain types of transactions or objects. For example, federally-owned land is exempted from property tax.

**Expenditure**
The actual payment for goods and services.

**Fee**
A charge to the consumer for the cost of providing a particular service. California government fees may not exceed the estimated reasonable cost of providing the particular service or facility for which the fee is charged, plus overhead.

**Forfeiture**
See fines, forfeitures and penalties.

**Fines, Forfeitures and Penalties**
Revenues received and/or bail monies forfeited upon conviction of a misdemeanor or municipal infraction.

**Fiscal Year**
The period designated by the city for the beginning and ending of financial transactions. Nearly all city fiscal years begin on July 1 and end June 30 of the following year.

**Franchise Act of 1937**
Like the Broughton Act, restricts franchise collections to 2 percent of gross annual receipts, but includes a minimum fee of 1/2 percent of gross annual receipts for electric franchises or 1 percent of gross annual receipts for gas or water franchises operating within the city limits.

**Franchises**
Fee paid to a municipality from a franchisee for “rental” or “toll” for the use of city streets and rights-of-way.

**Functional Revenue**
Revenues that can be associated with and allocated to one or more expenditure function and which meet one of the following criteria: 1) the revenue is generated from direct services, such as revenues from fees or charges; 2) the revenue is associated with a specific service by external requirements, such as grant conditions, bond sale agreements, or statutory or charter requirements.

**Fund**
Accounting entity with a set of self-balancing revenue and expenditure accounts used to record the financial affairs of a governmental organization.

**Fund Balance**
Difference between the assets (revenues and other resources) and liabilities (expenditures incurred or committed to) of a particular fund.

**Full Faith and Credit**
Pledge by issuer of general obligation bonds to bondholders that issuer guarantees “all available funds” be used to pay bondholders should the project go into default.

**Full Service City**
A city that is financially responsible for the major categories of municipal services including police, fire, planning and parks services.

**GANs**
See grant anticipation notes.

**Gann Initiative**
See Appropriations Limit and Chapter 10.

**Gann Limit**
See and Chapter 10.

**Gasoline Tax**
See Motor Vehicle Fuel Tax.

**General Fund**
Fund used to account for all financial resources except those required to be accounted for in another fund (e.g., enterprise or grant funds). Usually, the General Fund is the largest fund in a municipality.

**General Law City**
A city that has not adopted a charter and is therefore bound by the state’s general laws, even with respect to municipal affairs. In contrast, charter cities have authority over “municipal affairs,” trumping state law governing the same topic. See also “charter city.”

**General Obligation (G.O.) Bonds**
Bonds issued through a governmental entity which have the legal authority to levy a tax on real and personal property located within the governmental boundaries at any rate necessary to collect enough money each year to pay for principal and interest due.

**General Revenue**
Those revenues that cannot be associated with a specific expenditure, such as property taxes (other than voter approved indebtedness), sales tax, and business license tax.

**General Revenue Sharing Program**
Federal program established in 1972 to share federal monies with state and local governments. The program was extended in 1976 and again in 1980, but was ended in 1986.

**General Tax**
A tax imposed for general governmental purposes, the proceeds of which are deposited into the general fund. A majority vote of the electorate is required to impose, extend or increase any general tax. See also “special tax.”
GO Bonds
See general obligation bonds.

Grant Anticipation Notes (GANs)
GANs are short-term borrowings of a public entity to eliminate cash flow deficits in anticipation of the receipt of a federal or state grant or loan. By issuing GANs, the public entity is better prepared to pay all project costs, particularly up-front processing and managerial costs.

Grants
Contributions of cash or other assets from another governmental agency to be used or expended for a specified purpose, activity or facility.

Highway Users Tax
See Motor Vehicle Fuel Tax.

Homeowner’s Property Tax Relief
Revenue from the state to offset city loss of property tax for state-imposed $7,000 per dwelling homeowner exemption.

Improvement Bond Act of 1915
Act which lets cities, counties, and “public” districts issue assessment bonds and bond anticipation notes. The 1915 Act does not authorize assessments.

Investment Earnings
Revenue earned from the investment of idle public funds.

Joint Powers Authority
The Joint Exercise of Powers Act authorizes local public agencies to exercise common powers and to form joint powers authorities (JPAs) for purpose of jointly receiving or providing specific services.

JPA
See joint powers authority.

Landscaping and Lighting Act of 1972
The 1972 Act lets cities, counties and special districts levy assessments for land purchase and the construction, operation, and maintenance of parks, landscaping, lighting, traffic signals and graffiti abatement.

Lease Revenue Bonds
Bonds similar to certificates of participation and used for the same types of projects with main exceptions that: 1) lessor must be either a governmental entity with the power to issue revenue bonds or a nonprofit corporation that issues bonds on behalf of a political subdivision; and 2) the bonds constitute a direct debt of the lessor.

Levy
(Verb) To impose taxes, special assessments or service charges for the support of governmental activities; (noun) the total amount of taxes, and/or special assessments and/or service charges imposed by a governmental agency.

Library Services Special Tax
Special tax for providing public library facilities and services.

License and Permits
Charge designed to reimburse city for costs of regulating activities being licensed, such as licensing of animals, bicycles, etc.

Lien
A claim on assets, especially property, for the payment of taxes or utility service charges.

Limited Obligation Bonds
Similar to general obligation bonds except that security for the issuance is limited exactly to the revenues pledged in the bond statement and not to the full faith and credit of the city.

Liquidity
The ability to convert a security into cash promptly with minimum risk of principal.

LAIF
Local Agency Investment Fund. A special fund in the state treasury. Local governments may deposit in this fund through the state treasurer for investment purposes. See section 5.07.

Maintenance of Effort (MOE)
A requirement, often as a condition of an intergovernmental subvention or supplemental tax, to maintain a level of spending at a certain level. Maintenance of Effort requirements are intended to prevent or limit the use of the additional revenues to supplant existing revenues such that the new revenues result in an increase in the level of program spending and services.

Marks-Roos Bonds
Bonds authorized by the Marks-Roos Local Bond Pooling Act of 1985 which provide local agencies with extremely flexible financing powers through participation in joint powers authorities.

Market-Based Pricing
Recent trend in pricing public services which uses the marketplace to regulate individual consumer behaviors consistent with overall societal goals by including the true cost of the service on society.

Mello-Roos Bonds
Bonds allowing cities, counties, school districts and special districts to finance certain public capital facilities and services, especially in developing areas and areas undergoing rehabilitation. Property owners in the Mello-Roos district pay an annual special tax which is included on the property tax bill.

Mello-Roos Community Facilities Tax
Special non ad valorem tax imposed to finance public capital facilities and services in connection with new development. See Chapter Two section 2.11.

Mello-Roos Community Facilities District
A distinct entity of government for the purpose of imposing and collecting the Mello-Roos Community Facilities Tax. The governing body and the boundaries of the district may be the same as for the city. See section 2.11.

Motor Vehicle Fuel Tax.
18 cent per gallon tax on fuel used to propel a motor vehicle or aircraft. Use of tax is limited to research, planning, construction, improvement, maintenance, and operation of public streets and highways or public mass transit guideways. Also called Highway Users Tax and Motor Vehicle Fuel Tax.
Motor Vehicle License Fee (VLF)
VLF is fee for privilege of operating vehicle on public streets. VLF is levied annually at 2 percent of the market value of motor vehicles and is imposed by the state “in lieu” of local property taxes. VLF is also called Motor Vehicle in-Lieu Tax.

Municipal Improvement Act of 1913
1913 Act allowing cities, counties, and special districts to fund everything included in the 1911 Act plus power and public transit facilities; assessments can be levied before construction begins.

Off-Highway Motor Vehicle License Fee
Fee imposed for the issuance or renewal of identification for every off-highway motor vehicle.

Nexus
In general, a minimum threshold of connection necessary within a taxing jurisdiction to allow taxing authority over out-of-state individuals or businesses. Requirement of Government Code Sections 66000 et seq. that there be a reasonable connection “nexus” between required development impact fees and the development project in question.

Ordinance
A formal legislative enactment by the governing board of a municipality. If it is not in conflict with any higher form of law, it has the full force and effect of law within the boundaries of the municipality to which it applies.

Parcel Tax
Special non ad valorem tax on parcels of property generally based on either a flat per-parcel rate or a variable rate depending on the size, use and/or number of units on the parcel.

Parking Tax
General tax imposed on occupant of off-street parking space for privilege of renting the space within the city. See section 2.09.

“Pay As You Use”
Concept that debt financing enables the public entity to spread the cost of a capital project over time, as the project is being utilized.

“Pay As You Go”
Concept of paying for capital projects when the initial cost is incurred, rather than over time through the use of debt financing.

Penalties
See fines, forfeitures and penalties.

Police and Fire Special Tax
Special tax on parcels of property in support of police and/or fire protection services.

Portfolio
The collection of securities held by an individual or institution.

Possessory Interest
Taxable private ownership of interests in tax-exempt public property.

Property Related Fee
A levy imposed on a parcel or upon a person as an incident of property ownership for property-related service.

Property Tax
An ad valorem tax imposed on real property (land and permanently attached improvements) and tangible personal property (movable property).

Property Tax In Lieu of VLF
Property tax shares and revenues allocated to cities and counties in FY 2004–05 as compensation for Vehicle License Fee (VLF) revenues previously allocated to cities and counties by the State. Referred to in statute as “Vehicle License Fee Adjustment Amounts.” See section 2.01, page 19.

Property Tax Increment
See Tax Increment Financing.

Proposition 1A (2004)
Voter approved state constitutional amendment protecting the local allocation of state transportation sales tax revenues under Proposition 42 from reduction or shifting by the state Legislature. See section 6.03, page 114.

Proposition 4 (1979)
Also called the Gann Initiative, this initiative, now Article XIIIIB of the state Constitution, was drafted to be a companion measure to Proposition 13, California Constitution Article XIIIb. Article XIIIIB limits growth in government spending to changes in population and inflation. See Chapter 10.

Proposition 8 (1978)
An amendment to Proposition 13, passed in November 1978 to allow Assessors to recognize declines in value for property tax purposes. Revenue & Taxation Code §51 requires the Assessor to annually enroll either a property’s Proposition 13 base year value factored for inflation, or its market value as of January 1st, whichever is less. See section 2.01, page 17.

Proposition 13 (1978)
Article XIIIa of the California Constitution, commonly known as Proposition 13, which limits the maximum annual increase of any ad valorem tax on real property to 1 percent of the full cash value of such property.

Proposition 26 (2010)
A voter approved amendment to articles VIIIa and XIIIc of the California Constitution defining the term “tax” to mean all government imposed charges, levies or exactions are taxes except for seven specified exceptions. Any locally imposed charge that falls outside of the exceptions is a tax and requires voter approval.

Proposition 30 (2011)
Voters approved temporary increases in the state personal income tax and sales tax. Proposition 30 also provides certain guarantees of funding to counties for programs realigned from the state.

Proposition 42 (2002)
Voter approved measure that directs the Legislature to allocate revenues derived from the taxable sales of gasoline to certain transportation programs including to cities and counties. See section 6.03.
**Proposition 62 (1986)**
A 1986 proposition which, among other things, implemented a majority vote requirement for general taxes. This portion of Proposition 62 was later ruled unconstitutional.

**Proposition 98 (1990)**
This measure establishes a minimum level of funding for public schools and community colleges and provides that any state revenues in excess of the appropriations limit be spent on schools.

**Proposition 111 (1994)**
Voter approved measure that increased the state Motor Vehicle Fuel Tax by 9 cents per gallon and made certain adjustments to the spending limits under Proposition 4 (1979). See section 6.02 regarding the Motor Vehicle Fuel Tax and Chapter 10 regarding Proposition 4 spending limits.

**Proposition 172 (1993)**
A 1993 measure which places a one-half cent sales tax for local public safety in the constitution effective January 1, 1994. The tax is imposed by the state and distributed to cities and counties.

**Proposition 218 (1996)**
A voter approved state Constitutional amendment, self-titled “Right to Vote on Taxes Act” expanded restrictions on local government revenue-raising, allowing the voters to repeal or reduce taxes, assessments, fees, and charges through the initiative process; reiterating the requirement for voter approval for both “special taxes” and “general taxes,” and imposing procedural and substantive limitations on assessments of real property and on certain types of fees.

**Principal**
“Face” or “par value” of an instrument. It does not include accrued interest.

**Rating**
The designation used by investors’ services to rate the quality of a security’s creditworthiness.

**Real Property**
Land and permanently attached improvements.

**Real Property Transfer Tax**
Tax imposed on the transfer of ownership in real estate. Typically imposed instead of a Documentary Transfer Tax. Only Charter cities may impose a Real Property Transfer Tax. See Chapter Two Section 2.07.

**Reimbursement for State Mandated Costs**
Article XIIIb, Section 6 of the California Constitution which requires the state to reimburse local agencies for the cost of state-imposed programs. Process is commonly called “SB 90” after its original 1972 legislation.

**Regulatory Fee**
A charge imposed on a regulated action to pay for the cost of public programs or facilities necessary to regulate a business or other activity or mitigate the impacts of the fee payer on the community. A regulatory fee does not include a charge on a property or a property owner solely due to property ownership.

**Rents**
Revenues received through the rental of public properties to private parties such as convention space and library facilities.

**Resolution**
A special or temporary order of a legislative body requiring less formality than an ordinance.

**Revenue**
Annual income received by the city.

**Revenue Bonds**
Bonds issued to acquire, construct or expand public projects for which fees or admissions are charged. Bonds are repaid solely from the income generated by use of that project.

**Rough Proportionality Test**
Specific determination by the city for a specific development project that the dedication to be required is related both in nature and extent to the development’s impact. *(Dolan v. City of Tigard* (1994) 94 D.A.R. 8803).*

**Royalties**
Revenues received from private companies for privilege of extracting natural resources from city property. Also revenues from bets placed at horse racing tracks that are located within the city, currently set by statute at one third of one percent.

**Sales Tax**
A tax imposed on the total retail price of any tangible personal property. See also “use tax.” See section 2.02.

**SB 90**
Reimbursement process for state mandated costs, named after its original 1972 legislation.

**SB 1977**
1992 bill (Government Code, Section 54945.6 as amended) requiring local officials to mail notice of new and increased benefit assessments and to hold public hearings prior to imposing benefit assessments.

**Secured Property**
As the property tax is guaranteed by placing a lien on the real property, secured property is that real property in which the value of the lien on the real property and personal property located thereon is sufficient to assure payment of the tax.

**Secured Roll**
That property tax list containing all assessed property secured by land subject to local taxation.

**Securities**
Investment instruments such as bonds, stocks and other instruments of indebtedness or equity.

**Service Charges**
Charges imposed to support services to individuals or to cover the cost of providing such services. The fees charged are limited to the cost of providing the service or regulation required (plus overhead).

**Short-Term Financing Methods**
Techniques used for many purposes, such as meeting anticipated cash flow deficits, interim financing of a project, and project implementation. Using these techniques involves issuance of short-term notes. Voter approval is not required.
Special Tax
A tax that is collected and earmarked for a special purpose and deposited into a separate account. A two-thirds vote of the electorate is required to impose, extend or increase any special tax. See also “general tax.”

Standby Charge
A compulsory charge levied upon real property to defray in whole or in part the expense of providing, operating or maintaining public improvements. The charge is “exacted for the benefit which accrues to property by virtue of having water [or other public improvement] available to it, even though the water might not be used at the present time.” Proposition 218 classifies standby charges as “assessments” which must be imposed in compliance with Section 4.25 of California Constitution Article XIIIID.

Street Lighting Act of 1919
Act authorizing cities to fund the maintenance and operation of street lighting.

Subvention
Subsidy or financial support received from county, state or federal government. The state and county currently levy certain taxes that are “subvened” to cities, including motor vehicle license fees, state mandated costs and motor vehicle fuel tax.

Supplemental Law Enforcement Services Fund
County level fund to contain moneys from the Citizens Option for Public Safety state subvention for local law enforcement initiated in 1996. See section 6.04.

Supplemental Property Tax
In the event a property changes ownership, the county collects a supplemental property tax assessment in the current tax year by determining a supplemental value. In future tax periods, the property carries the full cash value.

Tangible Personal Property
Movable property.

Tax
Compulsory charge levied by a government for the purpose of financing services performed for the common benefit.

Tax Allocation Bonds
Bonds issued by redevelopment agencies to revitalize blighted and economically depressed areas of the community and to promote economic growth.

Tax Base
The objects or transactions to which a tax is applied (e.g. parcels of property, retail sales, etc.). State law or local ordinances define the tax base and the objects or transactions exempted from taxation.

Tax Equity Allocation (TEA)
Supplemental property tax allocations shifted to certain “no and low property tax cities” from counties. TEA is also used in reference to other supplemental allocations of Vehicle License Fee (VLF) revenues provided to certain no and low property tax cities. These VLF-TEA allocations now flow to those cities as a part of Property Tax in lieu of VLF payments.

Tax and Revenue Anticipation Notes (TRANs)
TRANs are short-term borrowings by a public entity to meet cash flow needs in the general fund and other unrestricted funds of a public entity. TRANs are issued before expected receipt of taxes and other revenues during the same fiscal year.

Tax Increment Financing
A tax incentive designed to attract business investment by dedicating to the project area the new property tax revenues generated by redevelopment. The increase in revenues (increment) is used to finance development-related costs in that district.

Tax Rate
The amount of tax applied to the tax base. The rate may be flat, incremental or a percentage of the tax base, or any other reasonable method.

Teeter Plan
Enacted in 1949, an alternative method for allocating delinquent property tax revenues, authorized by Revenue and Taxation Code section 4701, in which in which the county Auditor allocates property tax revenues based on the total amount of property taxes billed, but not yet collected. The county government then collects and keeps the delinquency, penalty and interest payments.

Traffic Safety Fund
All fines and forfeitures received as a result of arrests by city officers for Vehicle Code violations must be deposited in a special city “Traffic Safety Fund” to be used for traffic control devices; maintenance of equipment and supplies for traffic law enforcement and traffic accident prevention; the maintenance, improvement or construction of public streets, bridges or culverts; and the compensation of school crossing guards who are not regular full-time members of the police department.

TRANs
See tax and revenue anticipation notes.

Transactions and Use Tax
Also, known as an “add-on local sales tax,” a tax imposed on the total retail price of any tangible personal property and the use or storage of such property when sales tax is not paid. See section 2.03.

Transient Occupancy Tax
Tax levied by cities on persons staying 30 days or less in a room(s) in a hotel, inn, motel, tourist home, non-membership campground or other lodging facility. Also called Transient Lodging Tax or Hotel Tax. See section 2.06.

Triple Flip
A mechanism used to repay state fiscal recovery bonds pursuant to Proposition 57 of 2004. Under the Triple Flip, the local sales and use tax rate is reduced from 1.00 percent to 0.75 percent with the 0.25 percent diverted to repay state fiscal recovery bonds. Cities and counties are reimbursed for the lost revenue from a shift of property tax revenue. See section 2.02 page 26.

Tideland Revenue
Revenues granted by the state for use of city tideland in production of oil, gas and other hydrocarbons.

Transportation Tax
Special tax imposed by counties for county transportation needs. Typically collected with the sales and use tax, some cities receive a portion of the transportation tax usually in .25 percent tax rate increments.
**Unsecured Property**
As the property tax is guaranteed by placing a lien on the real property, unsecured property is that real property in which the value of the lien is not sufficient to assure payment of the property tax.

**Use Tax**
A tax imposed on the use or storage of tangible personal property when sales tax is not paid. See also “sales tax.” See section 2.02.

**User Fee**
Fees charged for the use of a public service or program such as for recreation programs or public document retrieval. User fees for property-related services are referred to as property-related fees. See Chapter 4.

**Utility Connection Fee**
Utility connection fees or capacity fees are imposed on the basis of a voluntary decision to connect to a utility system or to acquire the right to use additional capacity. See Chapter 4.

**Utility Rate**
A category of user fee paid by the user of utility services. See Chapter 4.

**Utility Users Tax**
Tax imposed on the consumer (residential and/or commercial) of any combination of electric, gas, cable television, water, and telephone services. See Chapter 2, Section 2.05.

**Vehicle Parking District Law of 1943**
The 1943 Act lets cities and counties purchase land for parking structures, construct and maintain parking lots, and pay for related planning.

**VLF**
See Motor Vehicle License Fee.

**VLF — Property Tax Swap**
The trade of most city and county Vehicle License Fee revenue for additional property tax share and revenue. See section 2.01, page 19 and Section 6.01, page 103.

**Vehicle Registration Fees**
See Vehicle Registration Taxes, Section 2.13 of Chapter Two.

**Vehicle Registration Taxes**
A special tax on vehicle registration imposed countywide for specific purposes authorized in state law. See section 2.13 of Chapter Two.

**Voter Approved Property Tax for Indebtedness**
Includes ad valorem property taxes levied in addition to the 1 percent rate for voter approved debt, approved prior to July 1, 1978 or after July 1, 1986.

**Williamson Act and Open Space Subvention**
State subvention to foster preservation of open-space by lowering cost of property tax.

**Yield**
The total amount of revenue a government expects to receive from a tax, determined by multiplying the tax rate by the tax base. Also, the annual rate of return on an investment, expressed as a percentage of the investment.
Top Tips

1. Obtain key documents:
   1) Annual Operating Budget
   2) Capital Improvement Program / Budget
   3) Comprehensive Annual Financial Report (CAFR)
   4) Long Range Financial Plan
   5) Interim Financial Reports
   6) Investment Reports

2. Develop and Use Financial Policies

3. Ask hard questions about programs:
   1) What is the purpose of this program? / Why is it needed?
   2) What are the specific intended outcomes of this program?
   3) What are the measurable objectives?
   4) What are the costs components: personnel, contracts, supplies, equipment, etc.?
   5) How will the costs of this program change in the future?
   6) What are the alternative service delivery approaches?
   7) Where will the money come from to pay for this?
   8) What are the consequences of not doing this program?

4. Know the difference between a “one-time” solution versus a “defer” solution versus a “sustainable” solution.
   a. One-time solutions fix a current problem, but not an on-going one.
   b. Deferrals “put-off” a problem by fixing a one time problem but create as much or more added costs in future years.
   c. A sustainable solution fixes an on-going budget problem now and into the future.

5. Unsustainable budget practices
   1) Exhaust the reserves
   2) Freeze vacant positions
   3) Make across the board cuts
   4) Defer equipment purchases
   5) Defer essential maintenance
   6) Defer pension or capital funding contributions
   7) Eliminate training
   8) Borrow from other funds
   9) Ignore the small cuts