Mayors & Council Members Advanced Leadership Workshops

City Finances – What You Need To Know

Friday, June 24, 2016

9:00am – 3:00pm

Monterey, California
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
Ken Nordhoff, City Manager, City of Walnut Creek
Drew Corbett, Director of Finance, City of Menlo Park

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<td>2. Financial Policies</td>
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<td>3. Budgets and budget processes</td>
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<td>4. Telling your story</td>
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<td>5. Financial reporting and auditing</td>
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<td>7. Pension and OPEB costs</td>
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<td>9. Ethical issues; purchasing best practices</td>
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<td>11. Milestones in municipal finance: a brief history, the state-local relationship</td>
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<td>12. Diagnosing financial health</td>
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<td>13. Top tips, closing charges, and Q&amp;A</td>
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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
5. The California Local Government Finance Almanac http://californiacityfinance.com/
City Finance:
What You Need to Know

Ken Nordhoff
City Manager
Vacaville

Michael Coleman
Fiscal Policy Advisor
League of Calif Cities

Drew Corbett
Director of Finance
City of San Mateo

Overview

- Financial Administration: Your Role as a Council Member
- Financial Policies
- The Budget and Budget Process
- Telling your Story
  - 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
  - Lunch and Questions & Answers (~12:00 noon)
- Cash Management and Investments
- Milestones in California Municipal Finance, the State-Local Relationship
- Diagnosing Financial Health, Financial Planning
- Top Tips
- Questions & Answers

Financial Administration and Your Fiduciary Role

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

City Council Member Roles

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

Act as a fiduciary agent for your City
- 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

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

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

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
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

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 objective** but not detailed steps in meeting that objective.
- Make policy **brief and concise**.
  - Example: “User fees should be reviewed and adjusted at least annually to avoid sharp changes.”
- Include “how to” steps in **administrative procedure**, if necessary.
- Leave exact steps of review/adjustment to staff.

Financial Policies

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

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???
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:
- 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)  
- Special Revenue Fund(s)  
- Capital Project Fund(s)  
- Others: debt service, trust, agency, internal service, special assessment

Budget Alternatives

**Term Types:**
- Annual -- Fiscal Year (July 1 – June 30)  
- Biennial Budget (two fiscal years)

**Budget Formats:**
- Line Item (old school!)  
- Performance  
- Program  
- Zero Based  
- Others...
Capital Improvement Program (CIP)

- For infrastructure or capital investment
- Funds come from a variety of sources:
  - Impact fees, restricted taxes, enterprise operations
- Subject to State Law--bidding process and prevailing wages
- Capital Improvement Program should look forward five years +

Policy:
- statement of plans for capital projects
- Specific Goals
  - e.g. PCI for roads
- Use of resources
  - Beyond needs?

Guidelines:
- preserve an existing asset?
- mitigate health or safety problem?
- mandated by State or Feds?
- contribute to City’s economic health?
- available funding for capital plus ongoing operations & maintenance?

Project Specific CIP

<table>
<thead>
<tr>
<th>CLASSIFICATION OF PROJECT</th>
<th>ORIGINAL APPROPRIATION DATE</th>
<th>PROJECT TITLE</th>
<th>GROUNDWATER MANAGEMENT PLAN</th>
<th>COST ESTIMATE</th>
<th>2012-13</th>
<th>2013-14</th>
<th>2014-15</th>
<th>2015-16</th>
<th>2016-17</th>
<th>TOTAL</th>
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<tbody>
<tr>
<td>WATER</td>
<td>2012-13</td>
<td></td>
<td></td>
<td>1,025,328</td>
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<td>100,000</td>
<td>100,000</td>
<td>0</td>
<td>1,125,328</td>
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<td>SITE ACQUISITION &amp; PREPARATION</td>
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<td>241,151</td>
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<td>100,000</td>
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<tr>
<td>CONSTRUCTION</td>
<td></td>
<td></td>
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<td>975</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<td>0</td>
<td>975</td>
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<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
<td>$1,329,456</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$1,600</td>
<td>$1,880,456</td>
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</tbody>
</table>

Budget Process

- A budget takes months of advance work
- Analytics for performance measures are needed early
- Performance standards ensure financial investment meets desired outcomes
- Your budget calendar and review process should be meaningful
- Your process should allow for needed input at the appropriate times
- Each agency does it differently!
The Budget Process

**BUDGET DEVELOPMENT**

<table>
<thead>
<tr>
<th>J</th>
<th>A</th>
<th>S</th>
<th>O</th>
<th>N</th>
<th>D</th>
<th>J</th>
<th>F</th>
<th>M</th>
<th>A</th>
<th>M</th>
<th>J</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GOALS</strong></td>
<td><strong>BUDGET PRIORITIES</strong></td>
<td><strong>WORKSHOP</strong></td>
<td><strong>LONG-RANGE PLANNING</strong></td>
<td><strong>WORKSHOP</strong></td>
<td><strong>BUDGET PROPOSALS</strong></td>
<td><strong>BUDGET ADOPTION</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff = Build Baseline &gt; Dept. Proposals &gt; Recommendations =&gt; Proposed Budget.</td>
<td></td>
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</tr>
</tbody>
</table>

**BUDGET MONITORING**

<table>
<thead>
<tr>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
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</thead>
<tbody>
<tr>
<td>Year-End</td>
<td>Mid-Year</td>
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</tbody>
</table>

**Budget Amendments**

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?

Ken Nordhoff

http://walnut-creek.org/home/showdocument?id=24

Property Tax

Where Does Your Property Tax Dollar Go?

- Local Schools: 40¢
- County: 14¢
- Other: 14¢
- GoCo Fire: 13¢
- Walnut Creek: 9¢
- Community College: 7¢
- East Bay Reg. Parks: 3¢
Residential Property Tax

Average residential property tax bill: $3,912*
Walnut Creek receives: $368

*base tax; does not include additional taxes such as school parcel tax, etc.

Sales Tax

6 ½ cents goes to the State
1 cent goes to Walnut Creek
½ cent to BART
½ cent to CCTA

Where your tax dollars go

Putting tax dollars toward priorities

- Parks and Open Space maintenance - $4.9 m
- Roads $4.2 m
- Police – $21.5 million
- Everything Else $10.8 m

$41.4 million total tax dollars used for General Fund programs
Critical Story Elements

• What are the key messages?
• Who is your audience?
• How are you delivering the messages?
• no more budget phone books!
• share successes and challenges
• persons and pictures preferred
• determine the best technology tools for delivery

What's Your Story?

Financial Reporting and Auditing

Drew Corbett

• The Comprehensive Annual Financial Report (CAFR)
• Letter of Transmittal
• Independent Auditor's Report
• Management Discussion and Analysis
• Financial Statements and Notes
• Supplementary and Statistical Information

Financial Reporting and Auditing

• 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
  - 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

**Statement of Net Position**

<table>
<thead>
<tr>
<th></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>
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<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>
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<tr>
<td>Debt Service</td>
<td>$5,000</td>
<td>$0</td>
<td>$5,000</td>
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<tr>
<td>Unrestricted</td>
<td>$55,000</td>
<td>$2,000</td>
<td>$57,000</td>
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<tr>
<td><strong>Total Net Position</strong></td>
<td><strong>$400,000</strong></td>
<td><strong>$25,000</strong></td>
<td><strong>$425,000</strong></td>
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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>
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</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>
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<tr>
<td>Committed</td>
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<td>$15,000</td>
<td>$35,000</td>
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<tr>
<td>Assigned</td>
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<td>$5,000</td>
<td>$14,000</td>
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<tr>
<td>Unassigned</td>
<td>$10,000</td>
<td>$0</td>
<td>$0</td>
<td>$10,000</td>
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<tr>
<td><strong>Total Fund Balances</strong></td>
<td><strong>$15,000</strong></td>
<td><strong>$15,000</strong></td>
<td><strong>$30,000</strong></td>
<td><strong>$80,000</strong></td>
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</table>
Notes to the Basic Financial Statements

- Note disclosures
  - Significant accounting policies
  - 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
  - Management’s discussion and analysis
  - Budgetary reporting
  - Pension and OPEB reporting

- Other supplementary information
  - Detailed financials for non-major funds
  - 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>
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<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>
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<tr>
<td>Ending Fund Balance</td>
<td></td>
<td></td>
<td>$15,000</td>
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</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 and the rest
• 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 Ins and Outs of State & Local Funds

The Mechanics of Government Revenue

Who pays?
visitors, residents, businesses, etc.

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

How’s it allocated?
site, pooled/population, etc.

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

Who collects & enforces payment?

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

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.

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**California’s Tax Revenue Structure**

<table>
<thead>
<tr>
<th>STATE</th>
<th>LOCAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income $60.8B</td>
<td>70% to local schools and counties, for state programs provided locally</td>
</tr>
<tr>
<td>Corporate $8.5B</td>
<td></td>
</tr>
<tr>
<td>Other state Sales&amp;Use $34.3B</td>
<td></td>
</tr>
<tr>
<td>VehLicFee(Tax) $1.9B</td>
<td>to counties for realigned programs</td>
</tr>
<tr>
<td>Motor Veh Fuel $7.2B</td>
<td>$2B to locals for roads/transportation</td>
</tr>
<tr>
<td><strong>Total State</strong> $79.6B</td>
<td>Property Tax $5.1B</td>
</tr>
<tr>
<td>Property Transfer $0.4B</td>
<td>Locally imposed sales taxes - collected by state BOE, - allocated to cities &amp; counties</td>
</tr>
<tr>
<td>License &amp; Permits $1.3B</td>
<td>Locally imposed, collected &amp; spent</td>
</tr>
<tr>
<td>Other $12.8B</td>
<td>$16B offsets state costs for schools</td>
</tr>
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</table>

Note: Not shown: user fees, franchises and other miscellaneous revenues.

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**Taxes and Fees/etc. Approval Requirements** *(California Constitution)*

<table>
<thead>
<tr>
<th>TAX-General</th>
<th>TAX- Parcel or Special (earedmarked)</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>Majority of the governing board.*</td>
</tr>
<tr>
<td>Special District</td>
<td>n/a</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>
</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 approval of majority of statewide voters.</td>
<td>Statewide majority voter approval</td>
<td>Majority of each house.</td>
</tr>
</tbody>
</table>

---

**California City Revenues**

- **Property Tax** 13%
- **Sales Tax** 7%
- **Taxes**
- **Fees**
- **State/Fed Aid**
- **Rents, penalties**
- **Other**

Not Restricted 35%

- **Utility Fees** (Water, Sewer, Refuse, Electr, Gas, etc.) 28%
- **Other Fees** 12%
- **State Grants** 4%
- **Federal Grants** 5%
- **Benefit Assessments** 2%
- **Special Taxes** 4%
- **Devt Fees & Permits 2%**
- **Licenses & Permits <1%**
- **Fines & Forfeitures 1%**

Source: CaliforniaCityFinance.com computations from data from California State Controller (revenues). Does not include data from the following cities that failed to report: Anza, Hesperia, Imperial, Lebec, Lindley, Placerville, Shafter, Zoar, and Wonderlane.
**Discretionary Revenues and Spending**

**Typical Full Service City**

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

**Revenues**

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

**Expenditures**

Source: Coleman Advisory Services computations from State Controller reports.

---

**California County Revenues**

Counties are hybrid local/state:
- countywide services: jails, courts, elections, property tax collection & allocation.
- "city" services to unincorporated areas

**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

Typical homeowner in a full service city not in a redevelopment area.

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>Source</th>
<th>Revenue as a Percent of Personal Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td></td>
</tr>
</tbody>
</table>

Sales Tax Collections

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

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.
The Ins and Outs of State & Local Funds

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

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

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

Pensions and Other Post-Employment Benefits (OPEB)

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 percentage of pay (non-pooled plans)
  - Expressed as a dollar amount (pooled plans)
Employer Contribution

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

- Changes in actuarial practices
- Changes in economic/demographic assumptions
- Poor investment returns in 2015 and 2016
- Risk mitigation strategy
Changes and Considerations

- Government Accounting Standards Board (GASB) Statement No. 68
  - Unfunded liability on balance sheet
    - Will impact your unrestricted net position
    - No impact to contribution rates
  
- Unfunded liabilities
  - Accelerated payments to CalPERS
  - Irrevocable trust

Other Post-Employment Benefits (OPEB)

- Largely under-the-radar until GASB 45
  - Difference between Actuarial Required Contribution (ARC) and actual contribution on balance sheet
    - No requirement to fund, but creates visibility
  
- Significant liability for many cities
  
- Cost continuing to increase
  - More retirees
  - Retirees living longer
  - Increasing healthcare costs

OPEB Changes on the Horizon

- Net OPEB liability on balance sheet (GASB 75)
  - Similar to change implemented for pensions (GASB 68)
  - Effective for financial statements for year ending 6/30/18
  
- Implied subsidy
  - Cost for retiree healthcare > healthcare premium
    - Value of implied subsidy in GASB 45 valuation
      - Valuations on or after 3/31/15
      - Will increase liability

OPEB Considerations

- Funding OPEB liabilities
  - 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
  - Negotiable item with bargaining associations
  - More flexible than changes to pensions
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>
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<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 municipally more opportunities to use cash on hand.</td>
<td></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* \(\leq\) 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 \(-55\% \text{ approval}\) of voters in district
- Must have Redevelopment Agency “Finding of Completion,” compliance with State Controller audit findings, conclusion of any outstanding legal issues.

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
    - How do you price a private placement?
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
Methods of Investing

• State law also prescribes process of investing (53690-53692)
  o Use of broker/dealers
    • Competitive transactions
    • Qualifications and conflicts
  o Delivery of securities and safekeeping (53608)

Investment Policy

• Foundation of investment goals and priorities
  o 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!
  o Managing liquidity

• Local Agency Investment Fund (LAIF) is important cash management tool
  o LAIF is part of State Pooled Money Investment Account
  o Good balance of yield and liquidity for everyday cash management

Ethics and Public Purchasing

Drew Corbett

• Ethics Principles and Laws
• Public Purchasing
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 council
- Exceptions do exist

Fairness in Purchasing

- Public contracting laws designed for fairness
  - Opportunity for all interested parties
  - Assurance public receives best value
- Public works contracts competitively bid
  - California law + local authority
- Professional services exception
  - Demonstrate competence and professional qualifications
  - Architectural and engineering services
- Special services exception
  - Specialized training for required services
  - Legal and accounting services
- Perception, perception, perception

Final Considerations

- Ethics laws have much greater scope than just purchasing
- Get educated on laws
  - Understand what staff does vs. getting yourself/your agency into trouble
- Resources – California Institute for Local Government:
  - [www.ca-ilg.org/trust](http://www.ca-ilg.org/trust)
  - [www.ca-ilg.org/everydayethics](http://www.ca-ilg.org/everydayethics)

Milestones in Municipal Finance: A Brief History

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

Michael Coleman
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).
   - 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.

### Milestones in Municipal Finance History

<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>Schools</td>
<td>57% reduction</td>
</tr>
<tr>
<td>1979</td>
<td>Cities, Counties, Special Districts</td>
<td>57% reduction</td>
</tr>
</tbody>
</table>

#### The AB8 (1979) Bailout

Shifting Local Property Tax to Cushion Impacts of Prop13

The AB8 "Bailout":
- Increased non-school shares.
- Reduced school shares.
- Paid more state general fund to schools.
**Milestones in Municipal Finance History**


- **Cities, Counties, Special Districts**
- **Property Tax**
- **Schools**

**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**

- **Prop 13 Property Taxes**
- **Prop 4 Spending Limits**
- **Prop 218 Taxes, Fees, Assessments etc.**
- **ERAF (Educational Revenue Augmentation Fund)**
- **Prop 1A Local & Protection**
- **Prop 22 Local & Protection Realignment**
- **Prop 26 Taxes, Regulatory Fee Rules**
- **Prop 42 State Sales Tax to Transportation**
- **Prop 57 Sales Tax "Triple Flip"**
- **VLF Shift Proposition 88 (Realignment)**

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

Fiscal road concept stolen from LAO
A brief history of the Car Tax (VLF)

- 1935 – State Vehicle License Fee (a tax) established
  - revenue subvened to cities and counties
- 1981-84 – Legislature diverts hundreds of millions of city & county VLF $s
- 1986 – Prop 47: VLF must go to cities and counties
  - but Legislature still decides the rate, the tax base and the allocation
- 1998 – Legislature & Gov Wilson pass VLF cut with backfill for cities & counties
- 2003 – Gray Davis admin pulls trigger, raises VLF
  - Davis Recalled, Schwarzenegger elected & cuts VLF without a funding source, punching a $4 billion ongoing hole in the state budget.
- 2004 – Legislature & Gov Schwarzenegger adopt VLF-Property Tax Swap and protect the property tax in Proposition 1A

The VLF-Property Tax Swap of 2004

- VLF Backfill
- Cities & Counties
- Property Tax in Lieu of VLF
- State General Fund
- Schools

The VLF, Incorporations and Annexations

The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

* in FY2004-05
The Lack of VLF Replacement Makes Many Annexations Fiscally Unviable

- Annexation of Inhabited Area (example)
  - VLF
  - Property Tax
  - Sales Tax

If incorporated before 2004 swap with AB1602 VLF patch (assumed in annex process)

Actual (after SB89 shift)

Municipal Financial Health Diagnostic

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

- Over-reliance on land development revenue
- Risky financing schemes
- Un sustainable Decline in Core Revenues
- Toxic relationships
- Ceding of management and policy choices to others

DIAGNOSING FINANCIAL HEALTH

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.

Diagnosing Financial Health

- 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
Forecasting and Financial Planning

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditures</th>
<th>Revenues</th>
<th>Fund Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>'14/15</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>'15/16</td>
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<td>'16/17</td>
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<td>'19/20</td>
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<tr>
<td>'20/21</td>
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</tr>
</tbody>
</table>

Expenses, Revenues, Fund Balance

Financial Planning  Sample Five-Year Forecast

Millions

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenses</th>
<th>Non-Operating Costs</th>
<th>OPEB</th>
<th>Capital Improv / Deferred Mtc</th>
<th>Less Favorable Revenue</th>
<th>Base Revenue</th>
<th>More Favorable Revenue</th>
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<tbody>
<tr>
<td>FY2013</td>
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<td>FY2018</td>
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</table>
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.
Chapter 1: Milestones in Municipal Revenues

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 “prevails over 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. 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.

**Constitutional Protection of Local Revenues: Proposition 1A (2004) and Proposition (2010)**

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.  

- 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 heals 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.

“The nation should have a tax system that looks like someone designed it on purpose.”
— WILLIAM SIMON
### 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

- **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.4

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

### 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.

### General Tax vs. Special Tax

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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>
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<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.5</td>
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- 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.
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.\(^{12}\)
- 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.\(^{13}\)

For More Information:


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.
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.
**Glossary**

**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.

Licenses 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 a fee for privilege of operating a 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.

**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 beginning 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 (2006)**

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 XIII A. 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 XIII A 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 VIII A and XIII C 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.
Glossary

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 X11B, 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 XIIID.

**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 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.
Financial Management for Elected Officials: Questions to Ask

Inside: Key Things to Know About
- Local Agency Financial Policies
- Budget Creation and Monitoring
- Financial Reporting
- Long-Term Financial Planning
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- Purchasing and Contracting Practices
- Finance Terminology (Glossary)

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**Introduction**

One of an elected official’s most important responsibilities is oversight of agency finances. Local agency finance can be complex. In addition, local agencies face significant financial constraints in California; this includes revenue instability due to state budget decisions and economic factors, state-mandated activities and procedural restrictions on raising new revenues.

What can elected officials do to exercise the kind of careful fiscal stewardship over taxpayer resources that the community expects?

This guide provides a series of tips and questions to assist elected officials in performing this important function. In reviewing these ideas, it is important to keep in mind that local agencies vary by size, complexity of operation, and scope of activities. As a result, some of the questions and practices described may not make sense for every local agency. For example, as a budget and accounting matter, some agencies perform one function and may therefore have one “fund.” Others may have multiple funds.

This guide is a starting point for conversations between local elected officials and staff. The ultimate goal is to help make sure that everyone is playing their necessary and proper roles as informed and responsible stewards of scarce public agency resources.

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Local Agency Financial Policies and Practices

Financial policies can provide a solid foundation for sound public agency fiscal practices. Adopted by the governing body, such policies provide:

- A means through which the governing body can communicate its collective policy judgments and goals to staff, the public and others.
- Direction to staff and standards against which current practices can be measured, and proposals for changes in practices can be evaluated.

Ratings agencies (who assess local agencies’ credit for borrowing) also look at local agencies’ financial policies; well-crafted polices can mean higher rating grades which can translate into lower borrowing costs.

Questions to Ask

Financial Policies

- Does the agency have written financial policies?
- If so, what do they cover? See sidebar on next page for a checklist of possible topics.
- How often does the governing body review them?
- With respect to each policy, is it clear who is responsible for implementing that policy?
- What procedures does management use to make staff aware of such policies? What training does staff receive to allow them to competently implement such policies?
- How does the agency monitor compliance with such policies?

Financial Practices

- Are agency accounting policies and procedures documented in writing?
- What kinds of practices does the agency use (sometimes referred to as “internal controls”) to make sure that the agency has systems for cross checks to minimize the risk of mistakes or maximize the likelihood that misconduct is detected?
- Does agency financial staff participate in relevant professional organizations to keep abreast of developments in the field and best practices?
• Are agency financial staff familiar with and do they adhere to the codes of ethics applicable to their professions? For example, both the California Society of Municipal Finance Officials\(^1\) and the California Municipal Treasurers Association\(^2\) have codes of ethics.

**Financial Planning Policies.**\(^3\)

- **Budget Policy.** Such a policy commits to a balanced operating budget (and defines what that is) and requires that decision-makers be alerted when deviations are either planned or otherwise occur.

- **Long-Range Planning.** Such a policy supports financial analysis and strategies to assess the long-term implications of current and proposed capital improvement needs, cost of services, operating budgets, budget policies, cash management and investment policies, program and assumptions. For example, a capital improvement plan enables the agency details the agency’s plans and relative priorities for making improvements to and replacing capital facilities (a process that normally takes years to complete).\(^4\)

**Checklist of Financial Policy Topics**\(^5\)

Local agencies have various—and various levels—of financial policies. Some policies relate to big picture, strategic topics (for example, budget policy, long-range planning and debt policy); others are very specific and practical policies (for example, credit card policies and expense reimbursement).

Having a range of policies (from big picture to practical and operational) helps an agency to chart a wise course financially and avoid operational missteps. Whether a specific policy makes sense given the nature and scope of an agency’s operations will vary.

- **Asset Inventory.** Such a policy requires an up-to-date listing of all major capital assets including. The policy can also require an assessment of asset condition and a plan for replacing assets (sometimes referred to as a “capital plan”). The definition of what constitutes a “major” asset is established by local policy, as is the determination of how often the inventory is to be updated.

- **Long-Range Planning for Pension and Other Post-Employment Benefit Costs.** Such a policy analyzes how the agency will meet the future costs of agency employee pensions and other employee benefit obligations.

- **Reserve and Other Fund Balances.** Such a policy enables decision-makers to maintain a prudent level of resources to protect against a need to reduce service levels or increase revenues due to revenue shortfalls or unpredicted one-time expenses. Specific kinds of reserves can also enable an agency to set aside moneys to replace assets (for example, fleet replacement reserves).
Revenue Policies. These policies help decision-makers understand and manage revenue flows.

- **Revenue Diversification.** Such a policy encourages a diversity of revenue sources to protect the agency against fluctuations in individual sources, such as sales taxes, which can rise and fall dramatically with the general economy.

- **User Fees and Charges.** Such policies establish the extent to which users of agency services are expected to cover the cost of providing the service and how those costs are determined. Note that most fees may only be used for the purposes for which they were collected and may not exceed the cost of providing the service for which the fee is charged. Such policies also can provide for regular review of fee levels and calculation methods to assure that the agency meets its objectives relating to cost-recovery on an ongoing basis.

- **One-Time and Unpredictable Revenues.** A goal of such a policy is to encourage the use of one-time or unplanned revenues for one-time needs or reserve replenishment rather than for ongoing expenses.

- **Limited Purpose Revenues.** By law or policy, certain revenues must be spent for specific purposes (for example, proceeds from special taxes). This policy explains which funds are restricted and why, limits their use to those purposes, and explains how the agency tracks their use to ensure the funds are spent only on permissible expenses.

Expense Policies. These policies enable decision-makers to manage and monitor how the agency incurs expenses.

- **Financial Reporting.** Financial reports compare actual expense levels (and revenue levels) to those predicted in the agency’s budget. This policy specifies the content and frequency (for example, quarterly) of these reports to decision-makers and the public.

- **Debt Financing.** This kind of policy allows an agency to specify when it can use debt for either short- or long-term needs. The policy also establishes what levels of debt and debt service payments are appropriate for the agency. It can also be a tool for complying with ongoing disclosure requirements associated with the agency’s debt and monitoring compliance with those requirements.

- **Expense Reimbursement.** Such policies determine the circumstances under which elected officials and staff may be reimbursed for expenses incurred in the course of their service to the agency. This includes setting limits on certain kinds of expense levels (for example, meals and hotel rates) according to community standards. Policies also specify the kind of documentation that must be provided to demonstrate that the expense was incurred in compliance with the policy before an expense will be reimbursed. Agency counsel should review the policy for compliance with AB 1234 and other state laws.
• **Credit and Purchase Card Use Policies.** The practice of issuing credit cards to agency officials and staff is increasingly rare because of the potential for misuse, either accidentally or intentionally. It can however, be useful to have one or more agency credit cards to make travel arrangements and the like. Some agencies also use purchase cards. A policy specifies controls to prevent misuse of such cards.\(^{10}\)

• **Petty Cash Policies.** Such a policy provides guidelines and accountability mechanisms for day-to-day cash handling by the agency and its departments.

**Cash Management and Investments.** State law requires agencies to adopt an investment policy specifying how the agency may invest funds not needed for the agency’s immediate and short-term needs.\(^ {11}\) Such a policy allows the governing body to establish and keep current the agency’s investment philosophy and risk tolerance. Although well-defined policies are more than a list of allowed investments,\(^ {12}\) such policies should be reviewed by agency counsel to make sure that the agency’s investments and practices conform with state law.\(^ {13}\)

**Purchasing/Procurement.** These policies determine the processes the agency uses in determining with whom it does business (including under what circumstances contracts are competitively bid) and which staff have decision-making responsibility in that area. Such policies also typically specify how the opportunity to do business with the agency is to be announced, with the goal being to reach
Budget Creation and Monitoring

Budgets are an agency’s tool for linking near-term goals with the resources available to achieve them, while keeping in mind long-term goals and resources and how the agency’s annual budget fits into its capital plan. Budgeting typically involves:

1. Establishing goals and priorities for the agency;
2. Allocating resources according to those goals and priorities; and
3. Comparing actual expenses and revenues to those estimated in the current budgeted expenses, making adjustments during the course of the budget year as necessary.

As important of a function as budgeting is, decision-makers may find that their options are limited in determining how the agency’s monies are actually spent. The limitations may result from legal restrictions on how funds may be used, matching funds issues (that will result in loss of revenues if the agency does not spend a certain amount), and state mandates.

Budgets play the following roles:

- **Financial Plan.** The budget document shows where agency revenues come from and how they are used. It demonstrates an agency's ability to meet recurring expenses with recurring revenues. As the fiscal year proceeds, there may need to be adjustments in the agency’s financial plan—the role of elected officials is to understand why such adjustments were necessary and what steps were taken to avoid having to make these adjustments.

- **Communications Tool.** The document also is an opportunity to explain to decision-makers, the news media, staff and the public:
  - What the agency does and why;
  - How the agency is organized to deliver programs and services;
  - The kinds of programs, services and activities planned for the budget period and what kinds of costs are involved;
  - Key fiscal issues facing the agency; and
  - How the agency assesses the efficiency and effectiveness of agency efforts (see also note on performance measurement on page 11).

- **Yardstick.** Once adopted, local officials and others can use budget numbers as a reference against which to compare expenditures and revenues throughout the year. As such, the budget provides an ongoing financial management tool to make sure the agency spends within its means and balances expenses against revenues.
The budget document should be easily understood by the average member of the community. To help make this happen, financial information can be presented a variety of ways (including text, tables and charts). Including performance measures in the budget document can help the public see the relationship between costs and benefits.

Because of the public information role the budget document serves, the Government Finance Officers Association recommends that budget documents be shared via the agency’s website.14

Questions to Ask

Role of Governing Body Members

- Do governing body members have a clear understanding of their role in the budget process?

- Do governing body members have a meaningful opportunity to shape major goals and objectives before the preliminary budget is prepared (for example, in budget workshops conducted sufficiently in advance of the preliminary budget’s preparation)?

- Do governing body members feel like they have been given an opportunity to understand and react to key decision points within a preliminary budget (versus being subjected to a long, random presentation about numbers)?

General Questions about the Numbers in the Budget

- What are the budget’s underlying assumptions (examples of key assumptions include population changes, projected case loads or service demands, state and federal funding, construction activity, utilities costs, service demands, inflation, and interest rates)? Are these assumptions realistic? What are the potential sources of uncertainty and risks regarding these assumptions?

- Does the budget explain the projections for the most significant general fund revenue sources? (These probably account for close to a large percentage of total general fund revenues.)

- For agencies providing social services, how are caseload and benefit costs forecast and managed?

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**Budgets Don’t Tell the Whole Story**

Operating budgets and financial reports do not address many important issues that decision-makers must consider. For example, they do not:

- Show postponed or avoided costs (for example, deferred maintenance on facilities or infrastructure)
- Use of one-time or expiring revenue sources.
- Indicate changes in purchasing power due to inflation or deflation.
- Measure the decline or depreciation of infrastructure (like roads, bridges and sewer lines) and public facilities (like buildings and parks).

Local officials may wish to ask staff to provide an analysis of how these variables affect the agency’s ability to deliver services and facilities.
• Does the budget summarize major expenses:
  o By function or program tied to areas of public service(s) or facilities the agency provides?
  o By category? (Examples include capital expenses, debt service, and operating expenses like staffing, contract services, and supplies).
  o By fund type? (Examples include the general fund and various enterprise funds, if the agency has special funds).

• Is the budget balanced by one-time fixes or is there a sustainable long-term funding strategy (this is also an issue to be addressed in the agency’s long-term financial planning documents, see page 14)?

• Does the budget clearly show the beginning and ending balances in each fund (fund balances)?

• Is the general fund budget balanced (in other words, are there enough projected revenues to fund estimated expenses)?

• Does the budget use one-time revenues only for one-time expenses (rather than ongoing expenses)?

• Does any fund have a deficit (in other words, is it projected to spend more than it brings in)? Why? Is it the deficit temporary or permanent?

• What are the most significant changes since last year’s adopted budget?

• With respect to the agency’s general fund, how is the fund balance projected to change?
  o How are other funds’ fund balances projected to change?
  o How will any resulting changes affect the agency’s compliance with its reserve policies?

• Does the budget compare actual expenses and revenues from past years so decision-makers and the public can understand how the agency’s budgeted numbers compared to reality?

• Does the budget show changes in the agency's overall financial condition? What measures of financial condition does it use?
• How does the agency’s budget compare with other agencies in the geographic area (both for the next fiscal year and the trend over the past five years)?
  o If there are differences, what are they and what factors account for the differences? (For example, are other agencies using different assumptions and why?)
  o Is the agency’s budget dependent on any other agencies, in terms of revenues (or expenditures)?
  o Are the other agencies planning changes that should affect the agency’s assumptions?

• Where is the agency in terms of constitutional limits on state and local spending? (In 1979 the California voters in 1979 approved a ballot measure\(^\text{15}\) that limited the growth in state and local spending to a formula tied to increases in population and inflation. Finance professionals sometimes refer to this as the “Gann Limit” named after the ballot measure’s sponsor. Local voters can approve an increase in the formula, for a period of up to years.\(^\text{16}\))

• If changes to the budget prove necessary during the fiscal year, why are those adjustments necessary? What steps were taken to avoid having to make mid-year changes? What steps can be taken to avoid such changes in the future?

Personnel-Related Questions

• What procedures does the agency use to forecast and manage projected personnel expenses?\(^\text{17}\) When do labor agreements expire?

• How does the agency set its salary and benefit levels or ranges?
  o Are there salary-setting guidelines available for positions within the agency? Has the agency considered and followed them?\(^\text{18}\)
  o Does the agency research and consider salaries and benefits other agencies provide for positions with similar responsibilities in the agency’s geographic area?
  o How are changes in compensation determined? For unrepresented employees not subject to a memorandum of understanding, are changes based on an annual goal-setting and performance review process? What other variables does the agency consider (overall agency fiscal health, public perception, relationship to other agencies’ practices, etc.)?
Note: If the agency uses employment contracts, carefully consider the potential future fiscal impacts of automatic contract renewals, automatic increases in compensation, and provisions linking compensation increases to third-party contracts. These may hamper the agency’s abilities to control its costs in the future.

- Are position vacancies monitored (including length of each vacancy), to determine if salary savings can be achieved, if position actually required, or if service levels are suffering?

- What is the status of the agency’s funding for pension and other post employment benefits liabilities?

Public Information and Transparency

- What processes will the agency use to inform the public about budget issues? What mechanisms will there opportunities will be provided for public input on budget challenges and priorities?

Are the agency’s budget and supporting documents made available on the agency’s website?

Note about Performance Measurement

“Performance measurement” (which is sometimes known by other names) enables an organization to assess its performance against organizational goals. This can occur as part of the budgeting process or as part of general management practices involving assessing the degree to which an organization’s activities and priorities are aligned with pursuit of an organization’s mission and strategy. Under either approach, the Government Finance Officers’ Association recommends that performance measurement be linked to budget decision-making. See www.gfoa.org/downloads/budgetperfmanagement.pdf

More specifically, performance measurement is a management tool for systematically collecting clearly defined data regarding the effectiveness and efficiency of service delivery. The initial questions for elected officials to ask are:

1) Whether and how the agency uses performance measurement to assess its activities,
2) If the organization uses performance measurement, how is the resulting data analyzed and used in management decision-making (including decisions on allocating resources), and
3) How are those results communicated to elected officials and the community?

There are a number of good sources on performance measurement for public agencies, including the International County-City Management Association (ICMA—icma.org/en/results/center_for_performance_measurement/home and the Government Finance Officers Association (GFOA—www.gfoa.org/index.php?Itemid=250&id=479&option=com_content&task=view).
Financial Reporting and Accounting

Financial reports are an essential oversight tool. There are two basic kinds of financial reports:

- **Interim Reports.** These include monthly reports, quarterly reports and mid-year budget reviews.

- **Annual Reports.** Well-managed public agencies typically prepare a report at the end of the year explaining revenues and expenditures levels.

In addition, local agencies that receive federal or other grant moneys may be subject to specific funder financial reporting requirements.  

Good interim reporting identifies important trends in time for local officials to act on them before serious problems arise. Audited financial reports alert governing body members if there are irregularities in financial practices and financial reporting. Both kinds of reports require a solid financial information system to track revenues and expenditures and provide that information to decision-makers.

Questions to Ask

Interim Reporting

- What kind of reports do agency managers receive? What do they do with them?

- How often do elected officials receive interim financial reports? Does staff review the information in these reports with local officials?

- Do the reports provide meaningful information that gives local officials an accurate portrayal of the agency’s current financial picture to date?

- Do the reports compare expectations with actual results? Do they discuss key variances between the two?

### Some Financial Warning Signs

- Operating expenses exceeding revenues by more than five percent during the year
- Large mid-year variances in budgeted revenues and expenditures versus actual
- Inadequate or late financial reports
- Depletion of reserves to balance budget, for example if the reserves fall below ten percent of operating costs.
- Outstanding loans between funds at the end of the fiscal year
- Expenses exceeding revenues for two consecutive years, with the second year’s deficit being larger than the first year’s
- Debt service exceeds 10 percent of current revenues
- Increase in debt service as percentage of operating budget each year
- Qualified auditor’s opinions
- Reports of internal control weaknesses from the agency’s auditors with no corresponding plan to address (or repeated reports of such weaknesses from year to year)
- Large turnover in staff responsible for monitoring financial status
• Are there adverse patterns?
• Does staff have a plan to address problem areas?
• Are there inconsistencies or conflicting trends?
• Do the reports identify areas of uncertainty or risk in any forecasts contained in the reports?
• Do the reports frequently contain surprises (unexpected developments)?

**Annual Reporting**

• Are the annual financial reports prepared by a certified public accountant, in accordance with generally accepted accounting principles? Are these reports audited by an outside or independent auditor?

• Have all the required disclosures, for example, those required by the Governmental Accounting Standards Board (GASB—sometimes pronounced “gaz-bee”) been made?

• How long has the outside or independent auditor been auditing the agency? Does the agency periodically change auditors every few years to provide a fresh view of the agency’s financial practices and reports?

• What is the relationship between the auditor and both the agency staff and the governing body? Is the auditor getting the information he or she needs in a timely manner? Is communication open and encouraged?

• Are the audited annual financial reports timely—within six months after year-end?

• Should the agency have an audit committee to select and supervise the work of the outside or independent auditor?²¹

• Are the auditors' opinions “unqualified?” (An “unqualified” opinion means that the auditor concludes the agency followed all accounting rules and that its financial reports present an accurate picture of the agency's financial condition. A qualified opinion is a significant warning sign that demands attention from the governing body.)

• Does the auditor prepare a transmittal letter that clearly and concisely describes the agency's fiscal status?

• Does the auditor issue a letter to the governing body reporting on the agency's internal controls?

• Does the agency follow the “Award for Excellence in Financial Reporting” guidelines of the Government Finance Officers Association?²² If not, why not?
Looking Ahead: Long-Term Financial Planning

- **Why Do Fiscal Forecasts?** Forecasting helps the agency think about the factors affecting the agency's fiscal health (and what can and cannot be done about them). Forecasting also helps elected officials, staff and the community understand the long-term fiscal challenges and opportunities they face, as well as possible advance warning of future uncertainties (for example, voter initiatives and state budget decisions).

- **Recognize Limitations.** Circumstances change and assumptions become outdated. Clearly stating the agency’s assumptions in making a forecast encourages the review, and re-evaluation of those assumptions, when necessary.

**Questions to Ask**

- Does the agency periodically prepare and / or update a long-term fiscal forecast?

- If so, does the forecast take into account key variables relating to revenues and expenses? Variables include demographic factors like changes in population and case loads. They can include economic factors like inflation, new construction, property values and the overall business climate (which can affect sales taxes). Other external factors can include legislative developments and court decisions. Projected costs related to pension obligations and labor agreements are another potential variable.

- Does the forecast reach clear conclusions about what these variables mean for the agency's future revenues and expenses?

- Does the forecast also identify areas of risk and uncertainty that may limit the degree to which the agency can rely on the forecast?

- To what extent are the results of the forecast shared with decision-makers, the news media and the public?

- What level of detail do decision-makers want to receive regarding the agency’s long-term financial planning? (Some governing bodies will want fairly detailed information whereas others will want bigger picture information. There is not a right level of detail – the goal is to give governing body members the level of detail that makes them comfortable.)
Cash Management and Investments

Sometimes, public agencies have funds on hand that are being held for longer-term needs. These may be invested in a variety of bonds (but not stocks), notes and other instruments allowed by state law.

The governing body’s role is to be a wise steward of the public’s resources. The objectives in managing public funds are, in priority order:

1. Safety (the likelihood that the agency will get all its money back)
2. Liquidity (the agency’s ability to withdraw funds on short notice)
3. Yield (the interest or other return on the investment)

In light of these objectives, prudent public agency investment managers never seek to earn maximum returns on the agency's portfolio at the expense of safety or liquidity. This would expose the agency to an unacceptable level of too much risk.

Instead, they focus on seeking to earn a reasonable rate of return on the agency's investments, while preserving capital in the overall portfolio and meeting the cash flow needs of the agency.

There are funds that specialize in investing public agency funds; the Local Agency Investment Fund (LAIF) of the State Treasurer’s office and CalTrust are examples.

Questions to Ask

- What oversight procedures does the agency use for its investments? Who is responsible for the day-to-day supervision of the agency’s investment activities? If that authority has been delegated to the agency’s treasurer, has that authority been delegated annually as required by law?23

- If that authority has been contracted out, who is responsible for oversight?

- What is the agency's investment policy? Is it understandable? Does the governing body review it annually as the law requires?24

- Do governing body members receive and review periodic investment reports?25 Do these reports include an analysis of cash flow needs?

- Are the investment reports clear and understandable? (A lack of clarity can be a sign of problems or undue investment complexity.)
• Do the reports show numerous investments and transactions? Why? (Many public agencies do not have portfolios that justify “active” management with lots of sales, purchases and trades.)

• Are the agency’s investments diverse or are the agency’s assets invested in just a few places?

• Do the agency’s policies allow investments in derivatives or other potentially high-risk instruments? Does that agency have any such high risk investments?

• Are any bank holdings over the FDIC insurance limit (which may vary from bank to bank) and do such depositories otherwise comply with state and federal standards to provide security for public agency deposits?26
Capital Financing and Debt Management

Debt financing is neither a “bad” nor a “good”—it is simply a tool for achieving community goals. However, debt does come at the price of costs of issuance and interest charges, as well as the obligation to make regular loan payments and conform to market disclosure and terms of the debt instruments on an ongoing basis. Allowing these payments to become a dominant part of the agency’s budget limits the agency’s ability to respond to unplanned expenses.

Debt financing is usually appropriate for:

- **Temporary Short-Term Cash Flow Issues.** An agency may need to bridge cash flow gaps while waiting to receive key revenues (like property taxes in December and franchise fees in April). The agency may cover these gaps by issuing “tax” or “revenue” anticipation notes (sometimes known by the acronym “TRANs”). In this case, any amount borrowed must generally be paid back within a year.

- **Long-Term Improvements.** Debt financing is also appropriate for truly high-priority, one-time improvements – when it makes sense for current taxpayers to share the cost with those who will benefit 20 or 30 years in the future. By contrast, borrowing for ongoing operational expenses or short-term capital needs is inadvisable. The length of the debt should never exceed the useful life of the debt-financed asset.

Any agency’s ability to borrow and repay debt capacity is limited. Amounts borrowed for today’s project are funds that cannot be borrowed tomorrow. Amounts required for debt repayment in the future are funds that will not be available for other programs and services.

Recognizing the significance of the decision to incur long-term debt for a public agency, California’s constitution requires the public voters to approve debt that would be repaid from future general fund revenues. While there are a number of exceptions to this requirement (including the special fund doctrine for revenue bonds and an exception for financing leases), the constitutional principle is important to keep in mind. Incurring debt obligates the community into the future and reduces financial flexibility. Accordingly, the benefits of doing so should outweigh these costs.

Questions to Ask

- Does the agency have a multi-year capital improvement plan? (Having such a plan enables decision-makers to consider key factors like project priorities, debt capacity and what role fees will play in financing).
  - If the agency has such a plan, is it realistic? If not, what steps are necessary to make it realistic?
If an agency has such a plan, what does the plan not include? For example, does it assume that new development will bear the costs of capital improvements necessitated by that development? If so, the plan should so state.

Does the multi-year capital improvement plan include specific information about how future maintenance costs will be paid for? It’s not wise to build an asset the agency cannot afford to maintain.

- Does the agency have clear capital financing and debt management policies? Who is responsible for implementing and monitoring compliance with these policies?
  - Do these policies provide decision criteria for when incurring debt is appropriate?
  - Do these policies address what type of debt financing is appropriate (for example, a) variable versus fixed rates, and b) are interest rate swap agreements allowable and under what circumstances?)
  - Do these policies address protection of credit quality?
  - Do these policies address debt capacity?
  - Do these policies address costs/benefits of risk examinations for proposed debt?
  - Do these policies address who is on the agency’s financing team and how consultants like bond counsel, financial advisors, trustees, assessment engineers and underwriters are selected? Are the selection criteria being followed?
  - Do these policies address disclosure to and relations with debt rating agencies?
  - Do these policies address who is responsible for conformance with bond covenants (obligations the agency agrees to as part of bond financing) on an ongoing basis?

- Does the agency have a debt advisory committee? If so, does the membership of the committee include representatives from the local community?
Purchasing and Contracting Practices

Procurement policies and practices enable an agency to promote maximum value and economy for the agency's constituents through fair and competitive processes. The goal underlying such policies is to select vendors and service providers using processes in ways that minimize opportunities for favoritism and that provide for competitive pricing. For service providers, the task also involves assessing whether the provider's skills best meet the agency's needs.

Purchasing presents a number of ethical and legal hazards for local officials, despite what can be a relatively small impact on overall agency spending. This is because missteps can undermine the public's overall confidence in the agency's financial practices. For more information, see www.ca-ilg.org/post/fair-procurement.

For public works projects, state law generally defines when local agencies must use competitive bidding.\textsuperscript{32}

Questions to Ask

- What steps does the agency use to have a fair, open and competitive purchasing process?
- Does the agency’s purchasing process explain the respective roles of staff and elected officials in that process?
- Have employees involved in the purchasing process received training or informational materials on the importance of both the appearance and substance of fairness in the procurement process?
- Are the purchasing rules straightforward enough so that everyone who has a part in implementing them understands the underlying goals and key rules? One element of clarity can be having separate policies depending on the nature of the purchase (for example, one for goods, one for services and another for public works projects).
- If the agency has a decentralized purchasing system (in other words, if purchase are made separately by different departments), does the agency have clear organization-wide standards and guidelines?
- Does the agency take advantage of cooperative purchasing opportunities with other public agencies?
- Does the agency have policies in place to comply with applicable prevailing wage requirements? These are especially common for vehicles and other big-ticket items.
- Would increased reliance on “just-in-time” deliveries that eliminate large inventories and warehouse systems be useful for the agency?
• Does the agency have policies in place for the proper disposal of surplus property? How has staff been made aware of such policies?

• Is the agency alert to and actively monitor contract terms for cost escalators and automatic renewals that can cause increases that can cause the agency to lose control of costs?

• Are staff responsible for purchasing decisions required to file annual disclosure statements relating to economic interests and gift receipt (known as “Form 700s”)?

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**Limits on Agency Expenses/
Proper Uses of Public Resources**

Invariably, there are more worthy uses for public funds than there are funds available. Deciding how limited public resources will be allocated is a key responsibility of elected officials, although it is important to acknowledge that decision-makers may have less discretion than one might expect in deciding how public monies are spent.

That being said, the law imposes some basic restrictions on how public resources may be used. For example, any use of public resources must serve the needs of the agency’s constituents. California’s Constitution expresses this principle by prohibiting “gifts” of public funds by the Legislature, general law cities, and agencies created by state statute; some city charters also contain this restriction. Agency counsel can provide guidance on the issue of what constitutes an impermissible gift of public funds. An example, however, is a payment to another public agency for their purposes, with no benefit flowing back to the donor agency’s constituents.

Along similar lines, personal or political uses of public resources also are not allowed. This prohibition applies to not only public money, but also to anything paid for with public money (for example, agency equipment, supplies and staff time). An example of how this prohibition applies is that public resources may not be used for advocacy efforts on ballot measures. (For more information, see [www.ca-ilg.org/BallotMeasureLegalIssues](http://www.ca-ilg.org/BallotMeasureLegalIssues). Elected officials should ask how staff and newly elected officials are made aware of these restrictions.

Finally, local agencies must adopt expense reimbursement policies for elected and appointed officials. Agency counsel should review the policy for compliance with state law. Most agencies have adopted expense reimbursement policies for staff as a matter of sound practice.
References and Resources

Note: Sections in the California Code are accessible at leginfo.legislature.ca.gov. Fair Political Practices Commission regulations are accessible at www.fppc.ca.gov/index.php?id=52. A source for case law information is www.findlaw.com/cacases/ (requires registration).

1  The California Society of Municipal Finance Official Code of Ethics can be found at: www.csmfo.org/index.cfm?fuseaction=Detail&CID=4&NavID=154.

2  The California Municipal Treasurers Association Code of Ethics can be found at: www.cmta.org/?page=4.


4  See GFOA website with long-term financial planning resources: www.gfoa.org/index.php?option=com_content&task=view&id=360&Itemid=186.


7  See, for example, Cal. Gov’t Code § 66016.


9  See Cal. Gov’t Code § 53232.2(b) (“If a local agency reimburses members of a legislative body for actual and necessary expenses incurred in the performance of official duties, then the governing body shall adopt a written policy, in a public meeting, specifying the types of occurrences that qualify a member of the legislative body to receive reimbursement of expenses relating to travel, meals, lodging, and other actual and necessary expenses.”). See also www.leginfo.ca.gov/calaw.html for additional information on what such policies must include.


13  See Cal. Gov’t Code §53600 and following (note that an agency is not required to authorize the full range of all investments allowed by state law). See also http://www.leginfo.ca.gov/calaw.html for specific statutory language.

See Cal. Const. art. XIIIIB (added by Proposition 4 on the 1979 ballot and sometimes referred to as the “Gann Limit” after the ballot measure’s leading proponent). See also Cal. Gov’t Code § 7900 and following.


32 For county projects, the threshold for complying with state law relating to public work contracts and bidding procedures is based on population: counties with populations of 500,000 or more ($6,500); counties with populations of 2 million or more ($50,000); and all other counties ($4,000). See Cal. Pub. Cont. Code §§ 20120-20123. See also Cal. Pub. Cont. Code § 20390-20409 (relating to work on county roads). For general law cities, public works projects worth more than $5,000 are subject to the state’s competitive bidding requirements. Cal. Pub Cont. Code §§ 20160-20162. The state’s Public Contract Code also has various competitive bidding requirements for special districts based on the kind of district. See Cal. Pub. Cont. Code §§ 20190-20381. Note that it is a misdemeanor to split projects to avoid competitive bidding requirements. See, e.g., Cal. Pub. Cont. Code §§ 20123.5, 20163.


34 See, for example, Golden Gate Bridge & Highway Dist. v. Luehring, 4 Cal. App. 3d 204 (1970).


36 See Cal. Gov’t Code § 53232.2(b) (“If a local agency reimburses members of a legislative body for actual and necessary expenses incurred in the performance of official duties, then the governing body shall adopt a written policy, in a public meeting, specifying the types of occurrences that qualify a member of the legislative body to receive reimbursement of expenses relating to travel, meals, lodging, and other actual and necessary expenses.”). See also www.leginfo.ca.gov/calaw.html for additional information on what such policies must include.
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The Institute for Local Government promotes good government at the local level with practical, impartial and easy-to-use resources for California communities.

The Institute is the research and education affiliate for the California State Association of Counties and the League of California Cities.

The Institute’s current program areas include:

- Local Government 101
- Public Engagement
- Public Service Ethics
- Sustainability

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1400 K Street, Suite 205
Sacramento, CA 95814
916.658.8208
www.ca-ilg.org
Public Engagement in Budgeting

Budgeting is one of the most important decisions local agencies make.

Why Involve the Public in Budgeting?

- The annual budget is typically the strongest statement of the local agency’s priorities for the community. As such, it is important that the community is involved in the development of this document.

- Meaningful public involvement can help residents understand the hard choices that budgeting entails, and assist policy-makers in better understanding the programs and services residents value most.

- Increased public understanding about local agency budgets, including revenues, expenses and challenges can lead to greater support for budgetary decisions as well as for measures to increase effective use of local revenues.

- Transparency about the local agency finances and the budget decision-making process promotes public trust and confidence in the agency’s stewardship of taxpayer dollars.

- The International County/City Management Association considers resident participation a core competency for successful public managers.

- The budgeting process allocates scarce taxpayer dollars to services, programs and facilities that play a key role in determining the community’s quality of life.

What Is “Public Engagement”?

Public engagement works to increase the extent to which residents become more informed about local issues and participate more effectively in local decision making. Approaches include:

- Public information
- Public deliberation
- Public consultation
- Sustained public problem solving


Probability: Belief that Sales Tax Rate is “Too High” When People Are:

Survey data suggest that local agency information sharing and public engagement efforts can lead to increased interest in ensuring adequate revenues to support local services.

Source: Center for California Studies, Civic Engagement and Local Fiscal Attitudes: 2013 Survey of Californians

For more, see www.ca-ilg.org/document/why-engage-public or www.ca-ilg.org/basics-public-engagement
Choosing the Right Approach Means Asking the Right Questions

- What type of input do staff and officials want from the public relating to budget decisions—a vision, an expression of broad community values, new ideas or choices among options, or ranked or unranked sets of ideas or preferences?
- How will the public’s preferences and/or ideas be considered in final budget decision-making?
- Is the goal solely a one-time process or also to build an ongoing local agency and community capacity for public engagement?
- In terms of the desired participation, is the goal to hear:
  - From a broad cross-section of community?
  - From those with present direct interest in the subject, including stakeholders or stakeholder groups?
  - Or a combination of both of these groups?
- What time period as well as financial and staff resources can be devoted to the effort?
- Is broader community understanding and support for the ultimate budget decisions the goal? How important is that goal?
- Is the local agency (elected and staff) clear about its public engagement commitment, goals, and process. Is there clear communication between elected officials and staff?
- How comfortable are policy-makers with public involvement in budget decisions? Are they willing to strongly consider community opinion, even if it means reducing spending elsewhere in the budget?

Tools to Consider

Once the purposes for engaging the public are clear, the task becomes selecting the approaches that best fit the goals. Often using more than one tool will secure the broadest participation.

Surveys: These provide a snapshot of public opinion at any given time; methods can include online, phone, mail, or in person (for example, using instant polling devices).

When to use: When seeking input on budget balancing choices or strategies.

Online Forums (Social Media): Technological platforms that allow for a virtual exchange of information and preferences.

When to use: To gather input from a large number of people, on their schedule, from their home or office.

Advisory Boards, Commissions and Committees: Community members, typically representing interests, groups, areas of expertise or geographic areas are selected to provide input on budget goals, issues, priorities and decisions.

When to use: When seeking to create a conduit for information between communities and local agency.

Workshops: Opportunities for information sharing, discussion and feedback on budget goals and issues.

When to use: Can give a significant number of community participants an opportunity to grapple with budget issues.

Deliberative Forum: Similar to a workshop, but usually involves more information sharing and increased time for participant dialogue.

When to use: When budget development is contentious and more in-depth and informed public input is desired.

Participatory Budgeting: Allocation of a portion of revenues for city projects and programs by residents, utilizing an extensive nomination, community forum and voting process.

When to use: When seeking to develop extensive community involvement in budget choices, particularly when there are significant differences of opinion in the community about spending new tax dollars or one-time funds, where community trust is low and/or where there are “new” revenues to allocate.
Communication and Engagement

Information and outreach are essential components of any public engagement strategy:

- **Budget and Financial Information.** For the public’s input to be helpful, it must reflect the realities of the agency’s fiscal situation. This requires that the public have appropriate and accessible information about both the budget process and the public agency’s finances.

- **Process Information.** Another component of the communications strategy is sharing information about the budget decision-making process and the opportunities residents have to participate in discussions and share their thoughts.

- **Inclusive Education and Outreach Strategies.** For decision-makers to hear from an informed and representative cross-section of the community, the agency must use education and outreach strategies that reflect the diverse ways that community members receive information.

- **Feedback Loops.** It is important that residents understand how their input influenced the ultimate budget. This could be accomplished through a community newsletter, a section of the budget narrative, or social media tools.

  ► More information: [www.ca-ilg.org/EffectivePE-Strategic-Communication](http://www.ca-ilg.org/EffectivePE-Strategic-Communication)

One Strategy: Start with Goals

The Government Finance Officers Association, the leading professional organization for public agency finance professionals, recommends that the budget process be tied to goals. Such goals can define what a community wants to preserve or what it wants to move toward (something GFOA calls the “preferred future state of the community”).

The budget process is a tool to realizing those goals, involving the allocation of resources to fund local agency services, programs and facilities which are a key part of the strategy for accomplishing the goals. Such goals also help decision-makers and the community set priorities for allocating limited resources.

Such goal setting can occur as part of the budget process or a separate strategic planning process. It is often helpful to begin the goal-setting process several months in advance of the annual budget process, so that the budget will reflect the key priorities of the city council and community.

**Goal Setting Question Example:** What are the most important things for the city/county/school/special district to focus on over the next five years?

A Strategy for Sustaining Public Engagement

A Working Group on Legal Frameworks for Public Participation has produced a model local ordinance for public participation as a tool for local agencies to use in committing to inclusive and authentic public participation in local agency decision-making processes.


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**Engage the Full Spectrum of Your Population**

*You may want to consider that participation in public engagement efforts more fully reflect community*

“The mission of the budget process is to help decision-makers make informed choices about the provision of services and capital assets *and to promote stakeholder participation in the process.*” [emphasis added]

—National Advisory Council on State and Local Budgeting
For Additional Information

- **A Local Official’s Guide to Public Engagement in Budgeting**
  www.ca-ilg.org/engaging-public-budgeting

- **Effective Public Engagement through Strategic Communication**
  www.ca-ilg.org/EffectivePE-Strategic-Communication

- **Broadening Participation**
  www.ca-ilg.org/broadening-participation

- **Transparency Strategies**
  www.ca-ilg.org/transparency-strategies

- **Public Engagement Key Questions for Local Officials**
  www.ca-ilg.org/PublicEngagementKeyQuestions

- **GFOA, Best Practices in Budgeting, Principle 1**
  www.gfoa.org/services/nacslb/introprinciples.htm#I

- **GFOA Resource: Best Practices in Budgeting**
  www.gfoa.org/services/nacslb/

- **Information on Local Agency Finance**
  http://www.ca-ilg.org/lBudgeting-finance

- **Evaluating Public Engagement Activities**
  www.ca-ilg.org/measuring-public-engagement-success

- **ICMA Resource: Practices for Effective Local Government Management**
  http://icma.org/en/university/about_management_practices_overview

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www.ca-ilg.org/engaging-public-budgeting

Institute for Local Government
1400 K Street, Suite 205
Sacramento, CA 95814
(916) 658-8208 • FAX (916) 444-7535 • www.ca-ilg.org