

THE STATE-CITY FISCAL RELATIONSHIP IN CALIFORNIA

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► **Service responsibilities differ among California cities.**

Less than 25% of California cities are responsible for all of the municipal services provided within their boundaries, such as police, fire, library, and parks and recreation. About one-third of the state's cities rely on a special district (or their county) to provide fire services. In about two-thirds, library services are provided and funded by another public agency. Thus the expenditures of individual cities vary greatly. Overall, public safety (police and fire services) and public utilities represent the largest components of city spending.

► **Cities rely mostly on their own revenue sources.**

Cities rely especially on property and sales taxes to pay for public safety and other general government. Charges for "enterprise" services (such as sewer, water, and waste disposal) raise more money, but generally this revenue can be used only to pay for the cost of providing those services. Unlike counties, cities receive little of their revenue (less than 10%) from the state or federal governments.

► **State law, especially through the initiative process, has restricted city revenue options ...**

Cities have struggled to raise revenue since the passage of Proposition 13 in 1978, which sharply reduced property taxes. They have used special taxes, fees and charges, special assessments, and other levies that either creatively comply with Proposition 13's requirements or fall outside its strictures. Over time, these alternatives have been significantly restricted by state law, primarily through other initiatives. The most notable of these, Proposition 218, approved in 1996, specifically restricts the use of many of these methods to raise local revenues. More recently, Proposition 26 in 2010 restricts state and local fees imposed as part of regulatory programs.

► **... while rearranging and reducing city revenues.**

Proposition 13 not only limits property tax rates but also allows the legislature to allocate the resulting revenue. Immediately after Proposition 13 passed, the state shifted property tax revenue to cities and counties and away from schools, making up the difference with state funds. It began reversing this shift in 1992, transferring property tax revenue away from cities and counties and back to schools and reducing state funding for schools. This change, known as the ERAF shift (for Educational Revenue Augmentation Fund) was deeply unpopular with cities. The state has also shifted other funds claimed by cities, including vehicle license fee (VLF) revenues; and it eliminated or severely restricted redevelopment agency funding in 2011. Many of these legislative maneuvers were later outlawed by initiative measures sponsored by California cities (Proposition 1A in 2004 and Proposition 22 in 2010).

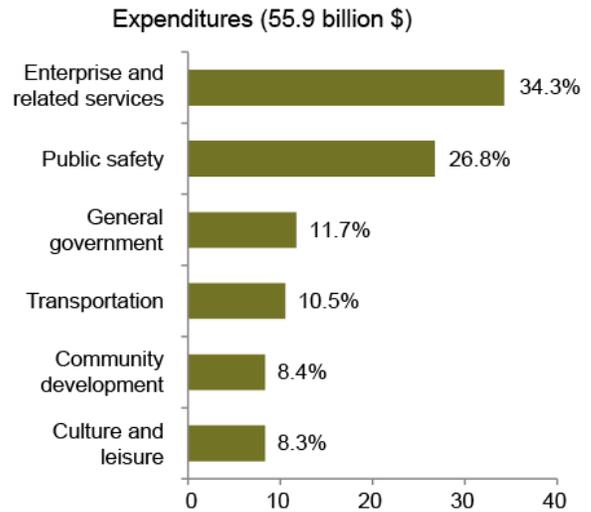
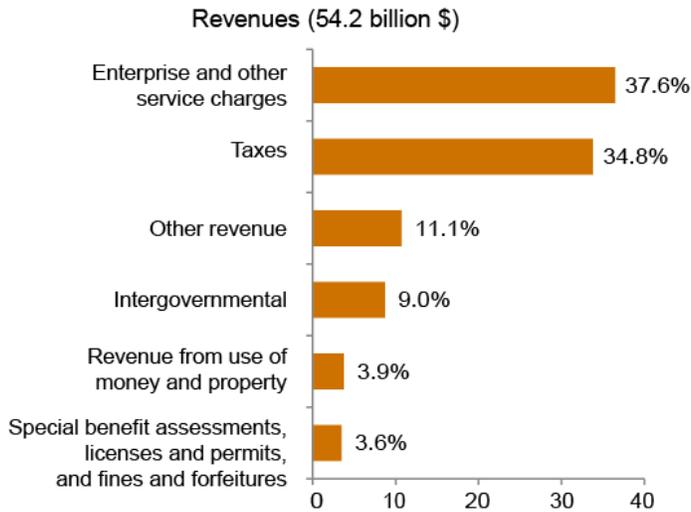
► **The state has sometimes required cities to undertake new responsibilities.**

The state can intervene in city finances by requiring that cities provide new services, or provide services differently than they have in the past, and such requirements can cost cities money. However, Proposition 4, approved in 1979, requires the state to reimburse local governments if state law "mandates" that they undertake new responsibilities. Proposition 1A strengthened this provision in 2004 by requiring the state to suspend any mandates for which it was not providing reimbursement. For example, state laws that require local governments to report information about violent crimes to the state Department of Justice or to publish agendas before local agency meetings have been held to be reimbursable mandates.



Enterprise activities are the largest city revenue source

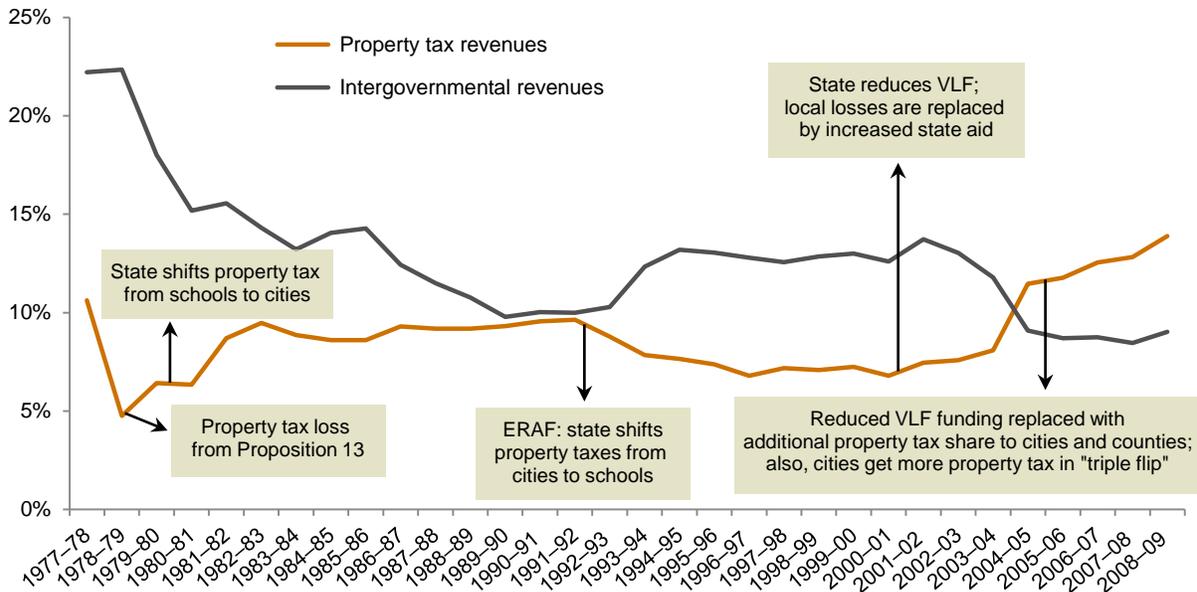
Public safety gets the largest share of city taxes



Source: California State Controller's Office Annual Report, FY 2008-09.

Notes: The "other revenue" category includes sale of real and personal property, contributions from non-government sources, and other financing sources (sale of bonds, notes, and other financial instruments). The "intergovernmental" revenue category includes 4.4% from the state and 4.6% from the federal and local governments.

Shifting policies have had a substantial effect on city revenues



Source: California State Controller's Office, Cities Annual Report (various years).

Notes: The sales tax triple flip is the mechanism by which the state reimburses cities and counties with property tax for local sales tax taken to pay off the Economic Recovery Bonds under Proposition 57 (2004). The VLF/Property Tax swap virtually eliminated VLF revenues for counties and replaced them with property tax revenues from ERAF.

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