Three Budget Topics

A Staff Briefing Paper for the Informational Hearing

9:30 a.m. to 12:00 noon
Wednesday, January 22, 2003
State Capitol, Room 3191

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Three Budget Topics

On Wednesday morning, January 22, 2003, the Senate Local Government Committee will hold an informational hearing on how Governor Gray Davis's budget proposals affect local governments. Of the many items in the Governor's budget that affect local governments, this committee hearing will concentrate on just three:

- vehicle license fees (VLF),
- open space subventions (Williamson Act), and
- public library funding.

The Committee recognizes that many other pieces in the budget are also important to local governments -- realignment, mandate deferrals, booking fee subventions -- but will not be discussing those items at this time. The Governor's redevelopment budget proposal will be the topic of a joint hearing with the Senate Housing and Community Development hearing on Thursday, January 23, 2003.

This background paper prepares the Senators and the witnesses to explore the Governor's proposals. In this paper, the committee's staff distinguishes among the proposals for the:

- Current year (2002-03).
- Budget year (2003-04).
- Out years (2004-05 and beyond).

The paper also suggests questions that legislators may wish to ask the witnesses.

Following introductory remarks by Senator Tom Torlakson, Committee Chair, and Senator Bob Margett, Vice Chairman, the Committee members will be briefed and hear testimony on three separate topics. Beginning with the VLF, the committee staff consultant and a representative from the State Department of Motor Vehicles (DVM) will describe how the VLF works and provide background information.

Following the staff briefing, the Senators will hear representatives from the State Department of Finance describe the budget proposal that Governor Davis has offered for legislative consideration. Legislators will then hear reactions and recommendations from city and county representatives and local elected officials.

Similar presentations will occur for the Williamson Act and public libraries. For those topics, after the briefings and Department of Finance presentations, Senators will hear reactions from counties, the Farm Bureau, and the American Farmland

Trust regarding the Williamson Act, and from the library community regarding library funding.

Motor Vehicle License Fees

The motor vehicle license fee (VLF) is a state fee on the ownership of a registered vehicle, in lieu of a personal property tax on vehicles. Motor vehicles were originally part of the local property tax rolls, subject to local property taxes. In 1935, legislators removed vehicles from local property taxation. Instead, they substituted a state-imposed vehicle license fee. The State returned the revenues from the VLF to counties and cities as a replacement for the revenues they would have received if vehicles had remained on property tax rolls.

The State Department of Motor Vehicles (DMV) administers the VLF. A registered vehicle owner pays the VLF on an annual basis based on the vehicle's depreciated sales price. The fee applies to cars, trucks, and motorcycles, as well as some trailer coaches purchased in 1980 or earlier. The fee is currently levied at a rate of 0.65% of the vehicle's current estimated value, determined by a statutorily defined depreciation schedule (shown in Figure 1.) The fee is deductible for federal tax purposes for vehicle owners who itemize their deductions.

Figure 1: VLF Depreciation Schedule

Year of Registration	Percent of Sales Price Used in VLF Calculation: Motor Vehicles	Trailer Coaches
1	100%	85%
2	90%	70%
3	80%	55%
4	70%	45%
5	60%	40%
6	50%	35%
7	40%	30%
8	30%	25%
9	25%	24%
10	20%	23%
11 and beyond	15%	22% (declining 1%/year until year 18)

Significant Changes to the VLF.
The vehicle license fee has changed surprisingly little over its 68-year history. The rate was constant for more than 50 years, changing for the first time only recently.

Constitutional Guarantee of Revenues to Local Governments. Since 1935, the State had traditionally returned the VLF revenues to counties and cities. However, in the early 1980s, facing financial difficulties, the State began to keep some of VLF revenues that otherwise would have gone to counties and cities. In reaction to this practice, the voters passed Proposition 47 (1986), a constitutional amendment ensuring that all VLF revenues would go to cities and counties. Proposition 47 did not affect the rate or the method of allocating VLF revenues. Control of the amount of revenue collected, as well as the formulas for distributing the revenues to cities and counties remain with the State.

Revenues Dedicated to 1991 Realignment Funding. In 1991, the Legislature changed the VLF depreciation schedules to help fund a major state-local realignment effort. The change slowed the rate of depreciation and, therefore, increased revenues. The new revenues, about 25% of the total VLF, were permanently dedicated to funding the realignment of state and local health and social services programs.

Rate Reductions. After the Legislature raised the VLF rate to 2% in 1948, it didn't change it for 50 years. Then, beginning in 1998, the Legislature made a series of cuts (officially known as "offsets") to the rate. Figure 2 shows the history, followed by more detailed explanations of the changes.

Figure 2: VLF Rates

Year	Rate
1935	1.75%
1948	2.00%
1998	1.50%*
1999	1.30%*
2000	0.65%*

*The rates shown for 1998 and beyond are "effective rates" that reflect statutory offsets to the 2 % rate.

- **1998** – AB 2797 (Cardoza). As part of the tax-relief package in the 1998-99 State Budget, the Legislature permanently reduced the VLF by

25% (effectively reducing the rate to 1.5%), with potential additional reductions tied to General Fund revenue growth. If sufficient revenues were available, the bill scheduled further reductions of 35%, 46.5%, 55%, and 67.5% in future years. AB 2797 also guaranteed that local revenue from the VLF would not be reduced because of the rate cuts. The State General Fund would backfill the gap. In addition, AB 2797 contained a reverse trigger mechanism. If revenues were not available to fund the local backfill, then the VLF reduction would be reversed in proportion to the shortage of funds.

- **1999** – AB 1121 (Nakano). The Legislature accelerated the 35% VLF reduction scheduled to begin in 2001 to 2000, but on a one-time basis for the 2000 calendar year. The backfill continued to be guaranteed.
- **2000** – AB 511 (Alquist) and SB 858 (Kuehl). In the 2000-01 State Budget, the Legislature further accelerated the VLF rate reduction, to 67.5%. (making the effective VLF rate 0.65%), starting in 2001. This legislation made the 67.5% VLF reduction permanent beginning July 1, 2001. Vehicle owners would see 35% of the cut as a rate reduction on their vehicle registration bills and the remaining 32.5% as a rebate check from the state after they paid their VLF bills. The reverse trigger mechanism for restoring the rate in bad fiscal times was removed.
- **2001** – SB 22 (Chesbro). The Legislature repealed the rebate mechanism effective July 2001, and continued the 67.5% VLF reduction on a permanent basis. The entire rate reduction is now reflected on the vehicle registration bills. The reverse trigger mechanism from the original 1998 legislation was reinstated, once again providing that if insufficient revenues are available to fund the local backfill, then the VLF reduction will be reversed in proportion to the shortage of funds.

The Backfill and theTrigger.

Each time legislators cut the VLF rate, the implementing bills told cities and counties that they would continue to receive the same amount of revenues, with the State General Fund backfilling the lost revenues. This approach recognized the VLF as a significant discretionary funding source for counties and cities. Because the backfill guarantee is in statute, not in the Constitution, it is vulnerable to legislative changes. To further protect local revenues, as well as protect the state General Fund, the Legislature added a reverse trigger mechanism.

The VLF reverse trigger mechanism provides that if sufficient revenues are not available to fund the local backfill, then the VLF reduction would be reversed in proportion to the shortage of funds. Whether or not this mechanism can be used,

however, remains controversial. The statutory language poses two problems. First, it is ambiguous as to which *person or agency* is responsible for pulling the trigger – some argue that it is the Department of Finance, others that it is the Department of Motor Vehicles. Second, the *definition of the General Fund* is so broad that the trigger could never be pulled. Last year's AB 1105, (Oropeza, 2002) would have clarified that the responsible person would be the Director of Finance, and corrected the General Fund definition. The Oropeza bill died on the Assembly Floor awaiting concurrence.

Figure 3 shows total VLF payments as well as the backfill amounts for several years.

Figure 3: VLF Payments and Backfill[a]

	VLF Paid	Effective VLF Rate		Backfill	Backfill and VLF
1994-95	$3,136,153	2.00		0	$3,136,153
1995-96	3,338,514	2.00		0	3,338,514
1996-97	3,536,009	2.00		0	3,536,009
1997-98	3,840,551	2.00		0	3,840,551
1998-99	3,699,894	1.50	(b)	$482,000	4,181,894
1999-00	3,295,706	1.30	(c)	1,324,000	4,619,706
2000-01	2,433,000	0.65	(d)	2,684,000	5,117,000
2001-02	2,911,000	0.65		2,460,000	5,371,000
2002-03 (e)	1,867,769	0.65		2,585,291	4,453,060
2003-04 (e)	1,899,688	0.65		987,014	2,886,702

(a) Does not include trailer coach license fees.
(b) VLF reduced by 25 percent effective 1999.
(c) VLF reduced by a cummulative 35 percent for 2000,
(d) VLF reduced by cummulative 67.5 percent beginning 2001.
(e) 2003-04 Governor's Budget.

Source: Legislative Analyst's Office.

Distribution of the Revenues.

The distribution of VLF funds is a complicated process, evolving from several budget agreements and other legislative actions. Figure 4 on page 6 shows the allocation process. About 1/4 of the revenue is dedicated to funding the 1991 state-local realignment of health and social services programs. The other 3/4 goes to "base VLF" for further distribution to cities and counties.

Figure 4

Most of the base VLF (80%) is split between cities and counties, distributed per capita. This allocation provides the bulk of local VLF funding. Another 19% provides "special allocations" to local governments based on historical agreements, including payments to no-and-low-property-tax cities. A small portion covers the DMV's administrative costs.

The Administration's Proposals.

- In the *current year* (2002-03), the Administration's proposal eliminates about 3/4 of the State General Fund VLF backfill to counties and cities, beginning February 1, 2003. The State would backfill only those funds dedicated to paying for the 1991 realignment and the Orange County bankruptcy bailout. This cut would save the State General Fund $1.3 billion in 2002-03.
- In the *budget year* (2003-04), the Administration proposes cutting the VLF backfill to cities and counties, retaining only the realignment and debt repayment in Orange County portions. The proposal would eliminate the backfill starting February 1, 2003, resulting in both *current year* and *budget year* impacts. This cut would save the State General Fund $3 billion in 2003-04, and $1.3 billion in the 2002-03.
- In the *out years* (2004-05 and beyond), the Administration's proposal would make these cuts permanent.

Legislative Alternatives.

Legislators have other options besides the Administration's proposals. Legislators could:

- Cut, rather than eliminate, the backfill in the current year or budget year, reducing the remaining payments to cities and counties by 25%, 50%, or some other percentage.
- Restore the backfill.

Policy Questions.

Legislators may wish to ask the Administration and other witnesses to explore the policy consequences of cutting the VLF backfill payments.

► *How will local officials react to the midyear loss of the state reimbursements? Can local budgets survive the loss of $1.3 billion in 2002-03?*

► *How will local officials react to the budget year loss of the state reimbursements? Can local budgets survive the loss of $3 billion in 2003-04?*

► *How do these losses compare with other historical local government funding cuts, such as ERAF?*

► *What local public services will be affected by the funding losses?*

► *What are the long-term consequences relationship of this proposal for the state-local relationship?*

► *What department can raise the VLF rate be raised under current law? DMV? Finance? What changes need to occur for the trigger to work?*

The Williamson Act

The Williamson Act conserves open space and agricultural land under a three-part statutory scheme:

- Voluntary contracts. Private property owners contract with counties and cities, agreeing to keep their land in open space, agriculture, or compatible uses.
- Reduced assessments. If a property owner signs a Williamson Act contract, the county assessor must lower the property's assessed value to reflect its agricultural use instead of its market value under Proposition 13.
- State subventions. The State General Fund sends subvention payments, known as "open space subventions," to counties to make up for the property tax revenues lost because of these lowered assessed valuations. Also, the General Fund automatically reimburses school districts for their lost property taxes with higher apportionment payments.

The 10-year Williamson Act contracts are self-renewing. Each year, a contract automatically extends for another year so that the contract always lasts 10 years into the future. Under the Act's Farmland Security Zone (FSZ) program, these self-renewing contacts last 20 years. The usual way to end a Williamson Act contract is *nonrenewal* in which either the landowner or the local government stops the contract's automatic annual renewal and the contract winds down over the next nine years (19 years for FSZ land). During the nonrenewal period, county assessors must raise the property's assessed valuation back to its full market value.

Property owners have voluntary signed Williamson Act contracts with 52 counties and seven cities covering more than 16.3 million acres of orchards, farmland, and ranches. Figure 5 on page 9 shows the number of contracted acres and state subventions for 2001-02.

Figure 5

In 2001-02, the State General Fund subventions to counties totaled $38.7 million. There is no current, reliable estimate of the state subventions to school districts but those reimbursements are over $60 million a year.
State subventions go to counties based on the land's location and quality:

For land in the Williamson Act:

- $5 an acre for prime agricultural land.
- $1 an acre for nonprime agricultural land.

For land in a Farmland Security Zone:

- $8 an acre for land within three miles of a city's sphere of influence.
- $5 an acre for prime agricultural land outside the three-mile line.
- $1 an acre for nonprime agricultural land outside the three-mile line.

Advocates say the Williamson Act achieves at least three statewide policy goals:

- The Act protects California's agricultural economy by cutting property taxes on farmland and ranches, lowering one of the industry's costs of production.
- The Act slows the conversion of open space and agricultural land to development by using nonregulatory, voluntary contracts.
- The Act reduces the demand for public works and local services by restricting development on open space and agricultural land, promoting more compact development patterns.

Critics of the Williamson Act, however, counter with these arguments:

- The Act subsidizes agricultural operations that are not threatened by urban development. Most of the Williamson Act contracted land is in rural counties, well beyond expanding cities and the pressures of suburban sprawl.
- The Act does not deter the conversion of open space and agriculture to development. When suburban speculators want cheap land for development, there are multiple ways for landowners to get out of their contracts, including outright cancellation.
- The Act is not a cost-effective way to curb sprawl. There are better ways for the state government to spend $100 million a year to conserve land for agriculture and open space.

The Administration's Proposals.

- In the *current year* (2002-03), the Administration proposes no midyear changes to its subventions.
- In the *budget year* (2003-04), the Administration proposes to stop the State's open space subventions, saving the State General Fund approximately $38 million.

- In the *out years* (2004-05 and beyond), the Administration proposes to permanently eliminate the State's open space subventions.

Legislative Alternatives.
Legislators have other options besides the Administration's proposals. Legislators could:

- Cut state subventions in the budget year, reducing payments to counties by 25%, 50%, 75%, or some other percentage.
- Suspend state subventions in the budget year only.
- Defer state subventions in the budget year, paying counties the deferred amounts over several future fiscal years.

Policy questions.
Legislators may wish to ask the Administration and other witnesses to explore the policy consequences of cutting Williamson Act subventions.

► *How will county supervisors react to the temporary loss of state subventions? Can county budgets survive the loss of $39 million in 2003-04?*

► *How will county supervisors react to the proposed permanent loss of state subventions? Will they begin to "nonrenew" Williamson Act contracts to recover their lost property tax revenues?*

► *How will landowners react if counties nonrenew their Williamson Act contracts? Will nonrenewals increase farmers and ranchers' operating costs?*

► *How will development patterns change if counties can't offer Williamson Act contracts? Will nonrenewals accelerate the pressures of suburban sprawl? Can counties substitute regulations for voluntary compliance?*

Public Libraries

The County Library Act of 1911 required each county to form a library system to serve all county residents. Today, there are 172 local public library jurisdictions, with multiple branches. Because of the California Library Services Act of 1977, Californians have enjoyed cooperative library services for over 25 years.

The role of California's public libraries has evolved. Today, libraries are an extension of the public school system and play a crucial role in combating both

child and adult illiteracy. Many libraries provide preschool literacy readiness programs, summer reading programs, Homework Help Centers, reach out and read programs, and participate in Raising a Reader, the California Literacy Campaign, and the Families for Literacy Program. In addition, public libraries provide training and access to computer technology and the Internet to children and families who cannot afford home technology.

Funding Public Libraries.

Public libraries receive a combination of state and local revenues. Locally, they depend on property tax revenues and other city or county general fund support. In addition, voters in some communities have passed special taxes or benefit assessments to support their libraries.

State funding for the public libraries comes from the State Budget, and is intertwined with funding for the California State Library. The Governor's Budget contains many items affecting library services at all levels. This paper and the Committee's hearing concentrate on two items that most affect local libraries --- the Public Library Foundation and Transaction Based Reimbursements.

The Public Library Foundation. The Public Library Foundation (PLF) grants provide the primary state funding for local public libraries. Although never fully funded, the program was intended to replace some of the revenue lost in the funding cuts that followed Proposition 13. Libraries receive per capita grants for acquiring library materials, staff, operating expenses, and equipment. Many libraries fund their book budgets with these funds. Others use them to extend library hours, operate bookmobiles, or provide children's services.

This program has suffered a series of recent cuts. In 2001-02, the PLF was funded $53 million. It is currently funded at $31 million. Figure 6 on page 13 shows the sequence.

Transaction Based Reimbursements. Transaction based reimbursements (TBRs) repay local libraries for some of the costs they incur when they extend lending services beyond their normal clientele. Participation is voluntary, but nearly all libraries participate at some level. The State budgeted $12.1 million for these reimbursements in 2002-03.

Figure 6

The program has two components authorized by the California Library Services Act. *Direct Loans* include over-the-counter loans of materials by a California public library to a resident of some other California public library district. A library is reimbursed by the state for the net handling costs of loans made to and from the participating library's own residents. This program has two provisions of service, *Equal Access* and *Universal Borrowing*. If a public library agrees to participate in the Equal Access provision it must provide non-resident loans to residents of public libraries that also participate in the program. If a public library agrees to participate in the Universal Borrowing provision, it must provide direct loans to all California residents. *Interlibrary Loans* include loans of materials from one library to another as a result of library user requests for the items. The state reimburses California public libraries for the handling costs of loans made to each other and eligible non-public libraries.

The Administration's Proposals.

- In the *current year* (2002-03), the Administration proposes reducing the Public Library Foundation (PFL) grants by approximately 50%. This cut saves the State General Fund $15.8 million in 2002-03.
- In the *budget year* (2003-04), the Administration proposes continuing the 50% reduction in the PLF grants, saving the State General Fund $15.8 million in 2003-04. The Administration also proposes eliminating transaction based reimbursements (TBRs). To offset these reductions, the Administration purposes to authorize local libraries to charge user fees to cover their costs of providing these loans. The fees would be about $1 for direct loans and $5 for inter-library loans. This shift will save the State General Fund $12.1 million in 2003-04.
- In the *out years* (2004-05 and beyond), the Administration proposes to make these changes permanent.

Legislative Alternatives.

Legislators have other options besides the Administration's proposals. Legislators could:

- Restore the PLF funding in the current year.
- Cut the PLF in current year or budget year by a lessor amount.
- Reduce TBRs, rather than eliminate them, allowing local libraries to charge smaller fees than those proposed.
- Dedicate a portion of the State sales tax to fund these programs.

Policy Questions.

Legislators may wish to ask the Administration and other witnesses to explore the policy consequences of cutting library support.

► *What is the policy rationale for reducing the PLF? The TBRs?*

► *How will local officials react to the midyear loss of the PLF? Can local library budgets survive the loss of $15 million in 2002-03?*

► *How will local officials react to the budget year loss of both the PLF and the TBRs? Can local libraries budgets survive the loss of $27 million in 2003-04?*

► *How will library services be affected by these cuts?*

► *How do these cuts compare to their losses under ERAF?*

Sources and Credits

These sources were useful in preparing this briefing paper:

California State Library webpage www.library.ca.gov

Governor Gray Davis, Governor's Budget, 2003-04, January 2003.

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Legislative Analyst's Office, "A Perspective on the Vehicle License Fee," Perspectives and Issues, 2002.

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