SMMUSD Financial Oversight Committee Meeting Minutes
Date: Thursday, December 3, 2020
Time: 6:00 pm to 8:00 pm
Location: Zoom
https://drive.google.com/file/d/1vRdEkFKhqKKo-gT94QnOTBbiatI1y8he/view?usp=sharing

I. Call to Order

6:05 pm

Committee Members:	Matthew Covington	Matthew Crawford
	Alex Farivar	Seth Jacobson
	Michael Kremer	Shawn Landres
	Renu Mevasse left @ 8:00 p.m.	Melinda Newman
	Payal Maniar	
	Natalie Ricciardulli, SAMOHI student rep left @ 9:00 p.m.	
Staff:	Ben Drati	Melody Canady
	Gerardo Cruz	Kim Nguyen
	Gail Pinsker	
Board Liaison:	Craig Foster	Jon Kean
	Laurie Lieberman	
Absent:	Gordon Lee	Marc Levis-Fitzgerald
	Kimya Afshar, Malibu Student Rep	
Public:	David Soldani, SMMUSD Legal Counsel left @ 8:07 p.m.	
	Shin Green, Eastshore Consulting left @ 8:07 p.m.	
	Jennifer Smith, Board member	

II. Approval of Agenda

6:05 pm

A motion was made by Ms. Newman and seconded by Ms. Maniar to approve the meeting agenda as amended with Agenda Item VII.A. Cashflow detailed by day for the months of November and December 2020 tabled to the January 7, 2020 FOC meeting.

AYES: Nine (9) (Mr. Covington, Mr. Crawford, Mr. Farivar, Mr. Jacobson, Mr. Kremer, Mr. Landres, Ms. Maniar, Ms. Mevasse, Ms. Newman)
STUDENT ADVISORY VOTES: One (1) (Ms. Ricciardulli)
NOES: None (0)
ABSENT: Two (2) (Mr. Lee, Mr. Levis-Fitzgerald)
ABSTAIN: None (0)

III. Approval of FOC Meeting Minutes

6:07 pm A motion was made by Mr. Landres and seconded by Ms. Newman to approve the October 29, 2020 meeting minutes.

AYES: Nine (9) (Mr. Covington, Mr. Crawford, Mr. Farivar, Mr. Jacobson, Mr. Kremer, Mr. Landres, Ms. Maniar, Ms. Mevasse, Ms. Newman)
STUDENT ADVISORY VOTES: One (1) (Ms. Ricciardulli)
NOES: None (0)
ABSENT: Two (2) (Mr. Lee, Mr. Levis-Fitzgerald)
ABSTAIN: None (0)

IV. Malibu Unification: How money flows to schools - Shin Green *(45 min)*

6:08 pm Dr. Drati provided a brief background and introduced Mr. Green and Mr. Soldani to the committee. Mr. Soldani provided the committee an overview of (9) of the (10) criteria for unification.

1) Number of Pupils. The reorganized districts will be adequate in terms of number of pupils enrolled.
2) Substantial Community Identity. The districts are each organized on the basis of a substantial community identity.
3) Division of Property. The proposal will result in an equitable division of property and facilities of the original district or districts.
4) Discrimination or Segregation. The reorganization of the districts will preserve each affected district's ability to educate students in an integrated environment and will not promote racial or ethnic discrimination or segregation.
5) Cost to State. Any increase in costs to the state as a result of the proposed reorganization will be insignificant and otherwise incidental to the reorganization.
6) Educational Programs of Existing and Proposed Districts. The proposed reorganization will continue to promote sound education performance and will not significantly disrupt the education programs in the districts affected by the proposed reorganization.
7) School Housing Costs. Any increase in school facilities costs as a result of the proposed reorganization will be insignificant and otherwise incidental to the reorganization.
8) Property Values. The proposed reorganization is primarily designed for purposes other than to significantly increase property values.
9) Fiscal Management or Fiscal Status. The proposed reorganization will continue to promote sound fiscal management and not cause a substantial negative effect on the fiscal status of the proposed district or any existing district affected by the proposed reorganization.

Ms. Green provided the committee answers to questions regarding territory transfer/unification related to financials and property tax matters.

Summary of the Education Code Section 35753 Conditions for Reorganization and whether such conditions can be substantially met in a reorganization of SMMUSD along with Mr. Green's presentation may be found at the end of these minutes.

V. Assistant Superintendent, Business and Fiscal Report: Melody Canady

VI. Discussion/Action Items

A. Cashflow detailed by day for the months of November and December 2020

This item was tabled to the January 7, 2021 FOC meeting.

B. Preview of 1st interim budget report

8:07 pm Ms. Canady and Mr. Cruz provided the committee with a preview of the 1st interim budget report that will be presented at the December 9, 2020 Board meeting.

The following 1st interim documents may be found in the following link:

- Presentation
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=82666&MID=4504
- Attachment
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=83159&MID=4504
- Multi Year Projection (MYP)
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=81818&MID=4504
- Fiscal Stabilization Plan
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=81817&MID=4504
- Traditional vs. Covid-19 Budget Line Items
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=81819&MID=4504
- Standard Account Code Structure (SACS) Report
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=81821&MID=4504
- Adopted Budget Review Letter From LACOE Re: First interim
  https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=81820&MID=4504

The Superintendent's Report of services, equipment, materials and/or supplies needed to mitigate the effects of COVID-19 and to reopen schools without a competitive solicitation for bids to respond to the emergency submitted at each regularly scheduled Board meeting under BP 2210, Emergency Resolution (Adopted 3/16/20), and Emergency Resolution No. 20-02 (adopted 7/16/20) may be found at:
https://simbli.eboardsolutions.com/Meetings/Attachment.aspx?S=36030435&AID=86372&MID=4723

VII. Ad Hoc Subcommittee Report

9:15 pm A. Budget Recommendations: Ms. Maniar, *Mr. Covington, Mr. Jacobson, Ms. Newman*

There was no report.

B. Tax Revenue and Assessed Valuation: *Mr. Farivar, Mr. Crawford, Mr. Kremer, Ms. Newman*

9:17 pm Mr. Farivar reported that the subcommittee met and will reach out to City of Santa Monica Assistant Treasurer regarding sales tax and report back with any updates. The subcommittee will review last year's subcommittee report to the Board and its recommendations.

C. Bond Oversight: *Mr. Kremer, Mr. Covington, Mr. Crawford, Mr. Lee, Ms. Mevasse*

9:15 pm Mr. Kremer reported that the subcommittee met and was scheduled to meet again to discuss suggested revisions to the debt policy, focusing on language that addresses refunding efficiencies and target levels. The Certificate of Participation (COP) was priced and is in this meeting agenda packet with other materials listed under receive and file.

The Post Pricing Book 2020 Certificates of Participation (COP) may be found at: https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/FinReports/PostPricingBookCOP2020.pdf

Mr. Landres requested that the record reflect his participation on the bond subcommittee upon change in full committee membership.

VIII. Receive and File (Limited Discussion)

8:26 pm

A. City of Malibu response to Dr. Drati letter on School Unification – 11/2/2020
B. Moody's Investor Service Rating Action – 11/10/2020
https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/Moodys-IS-Rating111020.pdf
C. Preliminary Official Statement 2020 Certificates of Participation (COP) – 11/11/20
https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/FinReports/PrelimOfficialStatement111120.pdf
D. 2020 COP (Property Acquisition & Refinancing Project) – 11/17/20
https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/FinReports/DBC2020COP111720.pdf
E. Certificate Purchase Agreement 2020 Certificates of Participation (COP) – 11/17/20 https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/FinReports/PurchaseAgreement-COP-Executed111720.pdf
F. Final Official Statement 2020 Certificates of Participation (COP) - 11/17/20
https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/FinReports/2020COPFinalOfficialStatement11172020.pdf
G. Frequently Asked Questions: Malibu Unification (Separation) – 11/23/20
https://www.smmusd.org/UnificationFAQ
H. Supplement to the 2020 Final COP Official Statement – 12/2/20
https://www.smmusd.org/cms/lib/CA50000164/Centricity/Domain/300/FinReports/COP-Supplement%20to2020OfficialStatement.pdf
I. Legislative Analyst Office - Understanding California Property Taxes dated 11/29/12

IX. **Public Comments** None

X. **Committee Comments** None

XI. **Next Meeting:** Thursday, January 7, 2021 – Zoom

XII. **Adjournment:** 9:19 p.m.

Education Code Section 35753 Conditions for Reorganization

In considering proposals for school district reorganization, the Los Angeles County Committee on School District Reorganization (County Committee) and the State Board of Education (SBE) must determine whether nine conditions, set forth in Education Code Section 35753(a), are substantially met. These conditions provide guidance to the County Committee and the SBE in considering reorganization petitions, but Section 35753(b) provides authority to depart from conditions if exceptional circumstances exist.

After an evaluation of the Education Code criteria, with guidance provided by California Code of Regulations (CCR), Title 5, Section 18573, and the California Department of Education (CDE) Reorganization Handbook, the City of Malibu believes that the reorganization of the Santa Monica-Malibu Unified School District (SMMUSD) into two separate school districts – Malibu Unified School District (Malibu USD) and Santa Monica Unified School District (Santa Monica USD) – will substantially meet the nine conditions for reorganization.

The following summarizes the conditions for reorganization and whether such conditions can be substantially met in a reorganization of SMMUSD.

1) ***Number of Pupils. The reorganized districts will be adequate in terms of number of pupils enrolled.***

   For a unified school district, the CCR sates that each affected school district should have an enrollment of at lease 1,501 students. The 2019-20 enrollment of each proposed district would exceed that figure, with an enrollment of almost 11,300 in Santa Monica USD and just over 1,500 in Malibu USD. However, projected future enrollment for Malibu USD shows that it could drop below this threshold if historical trends continue.

   Although enrollment may drop slightly below the targeted 1,501 students, this condition can be substantially met as the intent of this condition is that a school district will not be created that is more dependent upon county office of education and state support. For a future Malibu USD, the high property tax funding levels will result in a higher than average per student funding and enable this District to support quality educational program without additional county office or state support.

   Further, several students in the Malibu community do not attend public school. Many have opted for alternative education options due to ongoing concerns about the educational program currently provided to students in Malibu. With local control of the school district and high per student funding levels, many of these concerns can be addressed with the creation of Malibu USD and additional students could return to the public schools, thus increasing enrollment numbers.

2) ***Substantial Community Identity. The districts are each organized on the basis of a substantial community identity.***

   The geographic areas of the two proposed districts are not contiguous. The City of Santa Monica and the City of Malibu are distinctly separate communities with their own character and identity. The proposed reorganized district will result in schools that are better aligned with their respective community's identity.

3) ***Division of Property. The proposal will result in an equitable division of property and facilities of the original district or districts.***

It is reasonable to expect that property will be divided in an equitable manner should the reorganization be approved. School sites and vacant real property can be allocated to the district where such property is located. The existing support services buildings are located in the Santa Monica area and can be allocated to Santa Monica USD, which would require Malibu USD to build its own support facilities. Financial resources can be predominately be allocated utilizing Average Daily Attendance (ADA), with pension and OPEB liabilities allocated on a Full Time Equivalent (FTE) employee basis. Additionally, the districts should use assessed value to divide the bond interest and redemption fund balance, property taxes and outstanding bonded indebtedness.

4) ***Discrimination or Segregation. The reorganization of the districts will preserve each affected district's ability to educate students in an integrated environment and will not promote racial or ethnic discrimination or segregation.***

The CDE Reorganization Handbook offers careful instructions for analyzing this criterion. Based on the prescribed analysis of the data required to be reviewed, minority enrollment in the future Santa Monica USD and Malibu USD would not exceed the standards used by the SBE to determine when segregation occurs. Therefore, it is reasonable to expect that this reorganization will not promote racial or ethnic discrimination or segregation and this criterion will be met.

5) ***Cost to State. Any increase in costs to the state as a result of the proposed reorganization will be insignificant and otherwise incidental to the reorganization.***

Currently, the SMMUSD is a community funded, or "basic aid", school district and receives little State aid as local property taxes exceed its Local Control Funding Formula (LCFF) entitlement. With a reorganization, Malibu USD would remain "basic aid", but Santa Monica USD would be an LCFF district for at least a few years. The resulting loss of the property tax revenue attributed to Malibu would subsequently increase the state aid portion of the Santa Monica USD LCFF entitlement from the State.

To offset this increased cost to the State, Malibu USD can temporarily allocate a portion of its property tax revenue to Santa Monica USD until such time as Santa Monica USD becomes basic aid. The amount of the property tax allocation from Malibu USD to Santa Monica USD should be limited to the amount of State aid that would otherwise be required.

From a facilities funding perspective, there are no expected school housing costs, aside from one-time moving and possible renovation costs associated with creating a space to house the Malibu USD District Office and other support services.

6) ***Educational Programs of Existing and Proposed Districts. The proposed reorganization will continue to promote sound education performance and will not significantly disrupt the education programs in the districts affected by the proposed reorganization.***

The proposed reorganization would not result in substantial change to the existing program offerings of the schools located in Santa Monica USD. It is anticipated that after reorganization, all programs and staffing levels that are currently in place in the

Santa Monica portion of the District would continue in Santa Monica USD. Although programmatic changes could occur, such impacts would likely result from administrative decisions, not from the reorganization itself.

For Malibu USD, the existing educational programs could likely be enhanced and customized based on local needs and priorities, especially with the higher per student funding levels that Malibu USD will realize.

Thus, it is reasonable to expect that this condition will be met.

7) ***School Housing Costs. Any increase in school facilities costs as a result of the proposed reorganization will be insignificant and otherwise incidental to the reorganization.***

It is expected that both Malibu USD and Santa Monica USD will have adequate facilities to accommodate all of their students and educational programs for the foreseeable future, should the proposed reorganization occur. Malibu USD will need to make accommodations for support facilities and alternative high school programs, but such facilities needs can likely be addressed from a remodel of existing facilities. It is reasonable to expect that there would not be a substantial increase in school housing costs with this proposed reorganization.

8) ***Property Values. The proposed reorganization is primarily designed for purposes other than to significantly increase property values.***

In both Malibu and Santa Monica, the median home value far exceeds that of the state average. Since the attendance boundaries for the proposed districts are not changing from those currently in place, it is not likely that property values will experience any significant changes as a result of the reorganization.

Further, there is no evidence to suggest that property values is a factor that is driving the interest in the proposed reorganization effort by the Malibu community and there is no reason to presume that the petitioners' aim in reorganization is to increase their property values. Several factors have been identified, as stated in the Resolution adopted by the City of Malibu, that are driving the desire for reorganization, none of which are related to property values.

9) ***Fiscal Management or Fiscal Status. The proposed reorganization will continue to promote sound fiscal management and not cause a substantial negative effect on the fiscal status of the proposed district or any existing district affected by the proposed reorganization.***

Based on the proposed allocation of all funding sources, it is anticipated that the per student funding of Santa Monica USD and Malibu USD would exceed the current per student funding of SMMUSD. A multi-year budget projection for the future school districts shows that each district would be financially viable with continuation of the current parcel tax.

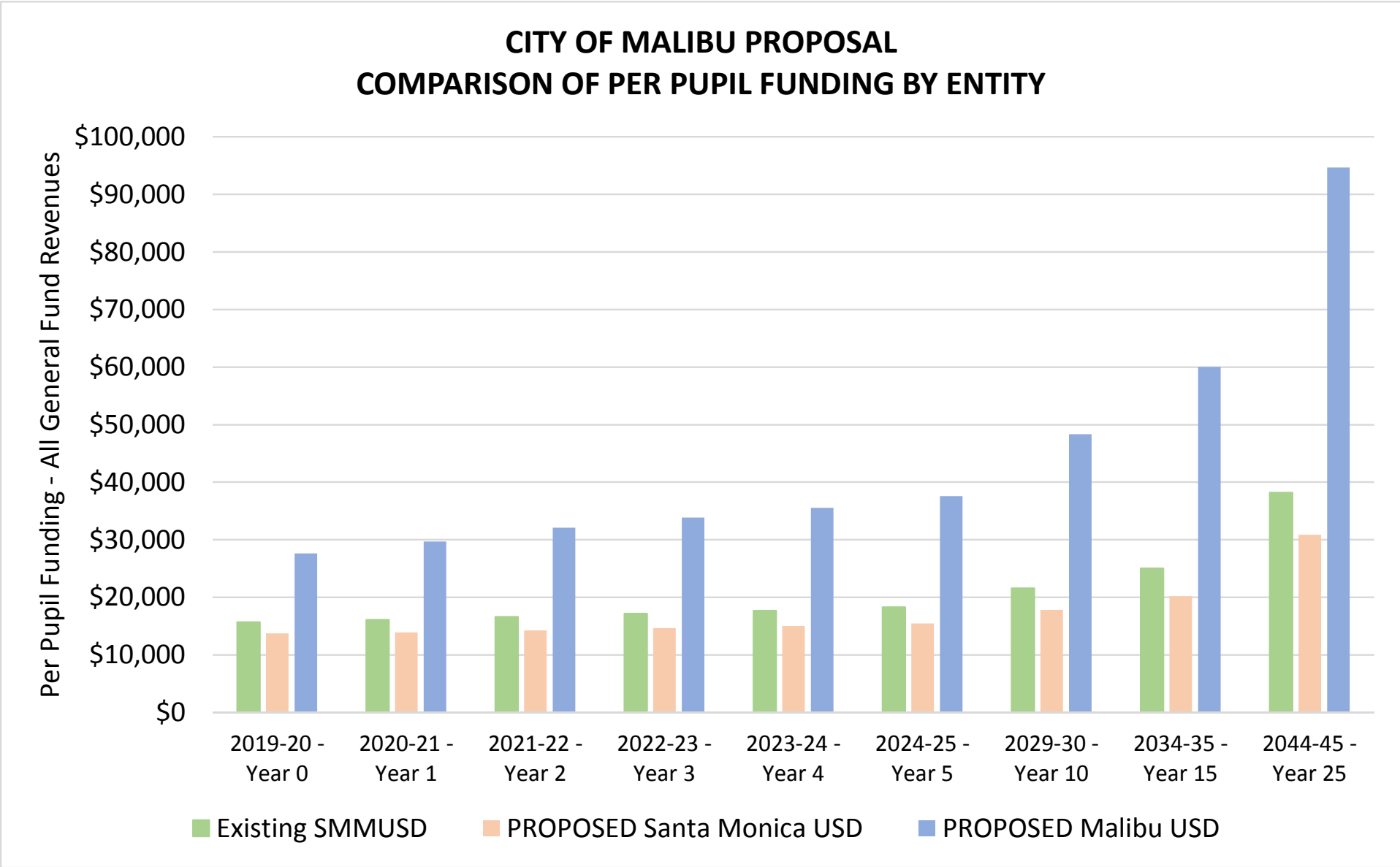
Santa Monica-Malibu USD

Answers to Questions Regarding Territory Transfer/Unification

December 2020

Overview

- The City of Malibu (City) put forward a Petition to divide Santa Monica-Malibu Unified School District (SMMUSD) into two discrete unified school districts, which was put on pause to allow for a mutually agreeable negotiated division of the District
- SMMUSD and the City were engaged in negotiations seeking agreement on an equitable allocation of revenues and addressing technical questions – with significant progress toward such an agreement in early 2020
- To SMMUSD's surprise, the City, without informing SMMUSD, opted to reach out to the Los Angeles County Committee on School District Organization (County Committee), requesting that its original Petition be considered without modification
- The City Petition would allocate the largest revenue source, property taxes, on the basis of tax base values in each territory, disproportionately allocating such revenues to the proposed Malibu USD
- SMMUSD is not in agreement with the Petition's proposed method of revenue allocation which leaves proposed Santa Monica USD students with less funding than they would otherwise have in a combined SMMUSD



Reflects total per pupil General Fund funding for the existing SMMUSD and proposed Santa Monica USD and Malibu USD – WITHOUT property tax transfers proposed by the City Petition.

Property Tax Split

What is the split in property tax revenues for pro forma Santa Monica USD and Malibu USD on an aggregated and per student basis?

- As proposed by the City of Malibu, property taxes would be split on the basis of the value of each territories' tax base
- The SMMUSD has rejected this proposed method of allocation as it disproportionately allocated property taxes to the proposed Malibu USD
- As proposed, the allocation would remove the proposed Santa Monica USD from "basic aid" status
- The City proposal indicates that they will potentially provide a transfer of property taxes from the proposed Malibu USD to the proposed Santa Monica USD to keep Santa Monica USD just above the minimum property tax required for basic aid status
- The City proposal would place Santa Monica USD students well below the level of property tax revenues they would otherwise benefit from in the combined SMMUSD

2020-21 PROJECTED PROPERTY TAX

	2020-21
Countywide 1% Property Tax Levy	$ 17,089,234,271
Gross Property Tax Ratio	0.006059743
Gross Property Tax Revenue	**$ 103,556,362**
Less: RDA Loss	26,472,119
Net 1% Property Tax Revenue	**$ 77,084,243**

Source: LA County 2020-21 AF91 Apportionment Report

2020-21 ASSESSED VALUES

	Assessed Value by Area	
Santa Monica Territory	$ 42,272,100,207	*67.1%*
Malibu Territroy	20,764,121,024	*32.9%*
Combined SMMUSD	$ 63,036,221,231	*100.0%*

Source: LA County Auditor-Controller

2020-21 PROJECTED PROPERTY TAX PER PUPIL BY TERRITORY

Proposed District	Assessed Value. Alloc.	Gross Property Tax	RDA Loss	Net Property Tax	2020-21 Enrollment	Per Pupil Property Tax
Santa Monica USD	67.1%	$ 69,444,913	$ 26,472,119	$ 42,972,794	8,449	$ 5,086.14
Malibu USD	32.9%	34,111,449	-	34,111,449	1,217	$ 28,029.13
Combined Total	100.0%	$ 103,556,362	$ 26,472,119	$ 77,084,243	9,666	$ 7,974.78

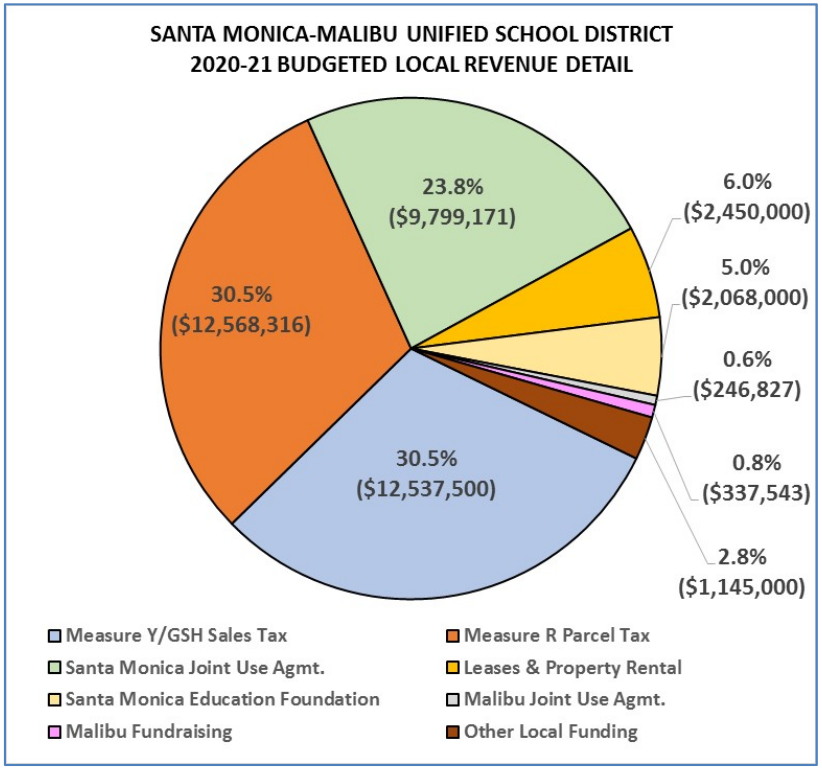
Excludes unsecured, delinquent and supplemental property tax revenues. Approximately $16.5 million ($1,955 per student) would be received in RDA funding which would apply only to SMUSD

- *Gross Property Tax Ratio is the share of countywide 1% property tax revenues received by a public entity. This ratio is adjusted each year in accordance with provisions of Prop. 13. The total of all public entities property tax ratios is 1.00, representing 100% of the revenues generated from the 1% property tax levy within in a county.*
- *Upon any split of SMMUSD, the County shall require direction on the division of the then in effect SMMUSD Gross Property Tax Ratio. The combined ratio of the resulting entities cannot differ from the ratio provided to the combined entity.*
- *RDA Loss reflects 1% revenues lost due to redevelopment agency activities. A portion of this lost revenue is reallocated to SMMUSD pursuant to pass-through agreements which generally provide less property tax revenue than is lost*
- *Redevelopment agencies are unique to Santa Monica and do not exist in the City of Malibu. As such, the entire RDA Loss would only be incurred by the proposed Santa Monica USD.*

Other Revenues

What other major sources of revenues currently support SMMUSD, and how would they be apportioned between Santa Monica USD and Malibu USD following a split?

- By far, the largest single source of funding for the current SMMUSD (and proposed subsequent districts) would be property taxes with non-LCFF revenues making up less than 30% of General Fund sources
- It should be noted that Redevelopment funding, which is exclusively derived from the City of Santa Monica territory property tax base, has a geographical nexus to the proposed Santa Monica USD
- Funding can basically be examined under two major aggregate categories:
  - LCFF Revenues – includes property taxes and, if applicable, State Aid funding subject to the LCFF formula
  - Local Revenues – includes a variety of locally generated funding sources, such as parcel taxes, sales taxes, and site lease and use revenues
- As indicated in the table provided on the subsequent page, certain revenue streams are geographically constrained
- The Petition proposal would allocate property taxes on the basis of each territories' tax base size and would appear to leave "local" revenues benefiting the territory from which they are derived
- The proposed allocation of property taxes is NOT how such funding is currently applied and is vastly different than the negotiated agreement parameters



- Local Revenue sources make up roughly 28% of current budgeted SMMUSD General Fund revenues
- The largest local revenue source, Measure R parcel taxes would continue to be levied after a split with each entity receiving funds generated from parcels within its boundaries
- Of a similar magnitude, Measure Y/GSH Sales Tax, is constrained to the education entity serving the City of Santa Monica where the sales tax is levied
- The other major local revenue source is Joint Use revenues which originate from activities in the City of Santa Monica

Local Revenue Source	2020-21 Budgeted Amount	% of Total Budgeted General Fund Revenues	Restrictions/Notes
Measure Y/GSH Sales Tax	$ 12,537,500	8.5%	Santa Monica Only
Measure R Parcel Tax	12,568,316	8.5%	More Parcel Per Student in Malibu
Santa Monica Joint Use Agmt.	9,799,171	6.6%	Santa Monica Only
Leases & Property Rental	2,450,000	1.7%	Mostly derived in Santa Monica
Santa Monica Ed. Foundation	2,068,000	1.4%	Santa Monica Only
Malibu Joint Use Agmt.	246,827	0.2%	Malibu Only
Malibu Fundraising	337,543	0.2%	Malibu Only
Other Local Funding	1,145,000	0.8%	Misc., mostly interest earnings
Total Local Revenues*	**$ 41,152,357**	**27.9%**	

** Excludes restricted revenue to support programs such as Special Education*

Personnel Impacts

What would budget for Santa Monica USD look like after all Malibu teachers were reassigned to Malibu USD or laid off? How many administrative positions and how much of the administrative budget would Santa Monica USD have to eliminate to get back to same per student spending we currently have?

- At this time, a full proposal inclusive of budget projections has not been provided by the City
- SMMUSD's team has endeavored to model the City's proposal to establish projected budgets into the future
- Teacher assignment is guided by code sections which govern reorganization of schools
- Seniority is the determining factor on which teachers end up where
- It is not 100% possible to speak to what a proposed Malibu USD would do with respect to personnel decisions and, as such, commentary about layoffs or staff additions cannot be answered by SMMUSD – this is a matter for the prospective Malibu USD Board to determine
- Based upon SMMUSD's analysis, it would be likely that administrative positions are scaled by proportionately to accommodate the reduced numbers for Santa Monica USD student populations and school sites
- No specific administrative reorganization plan has been developed at this point for a proposed Santa Monica USD and, as such, elimination of specific positions is not yet known

Student to Teacher Ratio Impacts

How much more would spending have to be cut to address higher Malibu per student real estate tax base? What number of teachers would we need to be laid off to adjust, and what would that do to teacher-student ratios?

- In reality, each subsequent entity would have its own revenue stream and the legislative board of each entity would be responsible for determining how such revenues are applied to support educational programs
- The City proposal would result in a reduced level of funding per student for the remaining Santa Monica USD estimated to start at roughly 13% of per pupil revenues as compared to a combined SMMUSD
- Currently, student to teacher ratios 22 to 1 for elementary grades and 27 to 1 for secondary grades within the Santa Monica territory
- While it cannot be determined exactly how a reconfigured Santa Monica USD will address personnel matters, resources to support each classroom would be reduced by 13%
- The comparative reduction to the combined SMMUSD would grow over time as the tax base grows and property taxes are disproportionately allocated to proposed Malibu USD students

Basic Aid & Funding

Would split leave Santa Monica USD as a basic aid district or not? If not, what would revenues look like for Santa Monica USD as a regular district with per student funding formula vs. basic aid formula?

- Per statements provided by the City's team, a proposed Santa Monica USD would be kept just above the basic aid funding minimum levels through the transfer of property tax revenues from the proposed Malibu USD to the proposed Santa Monica USD
- Such a transfer would be problematic as the City's proposed 33% allocation of existing property taxes to 17.5% of current SMMUSD enrollment creates a dynamic in which curing $1 of per pupil shortfall for a proposed Santa Monica USD "takes" $7 from each proposed Malibu USD student
- It appears that as proposed by the City, just enough property tax would be transferred to maintain Santa Monica USD just above the basic aid funding limits until such time as the Santa Monica USD allocation of property taxes grows enough to place it in basic aid without a transfer – an estimated 6 years or more
- Today, based on the Santa Monica territory demographics, via the LCFF formula, a proposed SMUSD would receive a projected $10,354 per student under LCFF – currently such revenues are at $10,812 per pupil for all SMMUSD students

Petition Process

What is actual process for Malibu to proceed with separation? What hurdles does Malibu USD have to meet to proceed?

- All petitions to modify the territory of a school district are evaluated under the State prescribed “Nine Criteria” using a process defined in State law
- As a City imitated petition, one extra step is included in the process – a preliminary hearing at which the County Committee will either approve continuation of the Petition review process OR deny the petition
- If the petition is allowed to continue by the County Committee several prescribed actions will occur including
- Public hearings in each affected territory to obtain community feedback
- A formal hearing of the County Committee to evaluate the Petition on the basis of the Nine Criteria
- A vote after the formal County Committee hearing on each criteria, followed by a vote on the overall matter
- If approved, the County Committee would then recommend an area of election on the matter
- Each party then has the option to appeal the County Committee determination to the State Board of Education – a process which can take several years
- There are certain criteria that SMMUSD does not believe the Petition satisfy – however, it is possible to for a petition to fail certain criteria but still be recommended for approval

Proposal Review Criteria

It seems like California has a real problem with very small inefficient school districts. Is there any legislative effort to prevent this balkanization based on real estate tax revenues?

- There is not any legislative guidance with respect to “real estate tax revenues” in the code guiding school district organization
- The nine criteria do provide a few “soft” requirements which are related to the question of size, efficiency and funding
  - Criteria #1 generally requires 1,501 students or more for the formation of a unified school district
  - Criteria #5 places a general requirement that reorganizations should not result in additional costs to the State of California
  - Criteria #9 generally requires that the financial viability of resulting school districts must be sufficient to allow for stable operations
- However, the SMMUSD case is truly unique as it is a rare occurrence of a basic aid district seeking division and, as such, does not fit well within exiting criteria

Precedents

What cases of school district breakups are relevant to this case?

- As noted in the prior question, this proposed “break-up” is fairly rare to have occurred due to the existing basic aid status and creation of two new school districts from a single existing district
- It is more common to have territory passed from one existing entity to another and it is exceedingly rare to have such districts in basic aid status
- Basic aid status creates a need to address property tax allocations, which may not be present in other proposed reorganizations
- Basic aid status is generally not in play because funding tends to be below State minimums and, as such, the State is held harmless (i.e. it does not incur increased costs) but rather has to allocate a similar aggregate amount of funding to the new entities – and from the classroom perspective, nothing is lost
- The oft-cited Wiseburn unification has a totally different set of facts and challenges than what is in play for the division of SMMUSD
- Our research has not identified a prior division of a basic aid district into two subsequent entities

Liability Mitigation

What happens to legacy liabilities? Would Malibu have to take share of responsibility for retirees proportional to student population or current staffing? Or can that be allocated based on real estate tax base?

- Legacy liabilities were discussed in negotiations and the pathway to addressing them was agreed upon
- Based upon conversations with potential providers, legacy facilities and personnel-related exposure to liabilities would be insured via a discrete policy, the costs of which would be shared by the two proposed school districts
- Actual employment-related pension liabilities would follow the employee and the aggregate of such liabilities for the employees retained by each proposed entity would become the sole liability of that entity
- It is important to note that PERS/STRS obligations are paid as incurred to provide a defined benefit in a pooled plan and not a specific pension offered solely by SMMUSD
- There would not be a tax base-related nexus under which these liability would normally be allocated

Existing MUSD Status and Agreements

What specific agreements are in place right now between SMMUSD and the proposed Malibu USD? Is there an agreement on how revenue from potential district office building sale would be split?

- No such agreements exist at this time, nor can they as there is not a legislative body for the proposed Malibu USD to ratify any such agreement
- Terms for the separation of territory would be memorialized in either an MOU between the City and SMMUSD in the case of a mutually agreed upon reorganization or in the outcomes of a plan as approved by the County Committee
- With respect to property needs and disposition, each resulting entity would receive full title and responsibility for the SMMUSD property within their respective territory
- There are an unknown number of potential things that may happen – all of which are the purview of the then in place governing bodies of each proposed district
- However, in prior negotiations, the City and SMMUSD had agreed to a conceptual framework which did allocate some additional revenues to a proposed Malibu USD in recognition of the need to set-up a centralized District Office

Facilities Matters

How does SMMUSD get paid back for investment in all the school sites, equipment, etc. currently invested in Malibu schools?

- While it may be conceivable to conduct a study to determine the “level” of contribution by each community, ultimately due to the nature of school facilities funding in California it is rare to seek consideration for “prior” investments
- To the extent the investment was from GO Bonds approved prior to a separation – the territory paying such combined GO Bonds would continue to pay until maturity
- It is for this reason that the latest GO Bond programs were undertaken as School Facilities Improvement Districts for each territory within SMMUSD
- Furthermore, investment of State funding for school facilities is not something that is due to either party
- The traditional approach is to allow each entity to keep the facilities within their respective boundaries and any future GO Bonds would be discrete to each territory

Conclusion

- SMMUSD is not adverse to a division of the existing district into two discrete school districts
- However, SMMUSD does not feel that the Petition as structured by the City of Malibu is an equitable pathway to such a division
- SMMUSD is concerned for the well-being of all students it currently educates and is not willing to proceed with a proposal that harms a majority of the student populations for the benefit of a small percentage of all students
- SMMUSD has not been provided with an in-depth analysis of the City of Malibu proposal – but the figures presented in public thus far create a great degree of concern and do not appear to accurately reflect the projected outcomes of their proposal
- The City of Malibu's insistence on a disproportionate allocation of property taxes reverts to a position which was previously rejected
- The proposed mitigation of providing a property tax transfer from a proposed Malibu USD to a proposed Santa Monica USD as stated in the City's forum would still result in a reduction in funding for Santa Monica USD students as compared to the combined SMMUSD
- This reduction may be mitigated for a single year under their proposal – but in all future years, the majority of SMMUSD students would have fewer resources available than if the District were to remain unified
- It is the hope of the SMMUSD team that the City of Malibu will return to the table to complete the nearly finalized negotiations which were underway – however, if they intend to proceed as indicated, SMMUSD will be compelled to fight the Petition

City of Malibu

23825 Stuart Ranch Road • Malibu, California • 90265-4861
Phone (310) 456-2489 • Fax (310) 456-3356 • www.malibucity.org

November 2, 2020 *Sent via Email to BDrati@smmusd.org*

Dr. Ben Drati, Superintendent
Santa Monica-Malibu Unified School District
1651 16th Street
Santa Monica, CA 90404

RE: Petition for Unification of a Malibu Unified School District

Dear Dr. Drati:

We are in receipt of your **letter** dated October 28, 2020, in which you express disappointment "in what appears to be a retreat to a position [you] thought we had all moved beyond in our discussions." We understand and share your disappointment, but let's take a moment to correct the record for those who have only recently been apprised of our progress.

First, your October 28th letter was the first correspondence we have received from Santa Monica-Malibu Unified School District ("District" or "SMMUSD"), despite our two attempts to engage in dialogue with the District on remaining terms material to our negotiated agreement. In both our letters of **April 21, 2020** and **June 1, 2020**, we asked the District to clarify its position on (1) the parcel tax special legislation, and (2) the City's proposal to revisit the redistribution of Malibu property taxes to the Santa Monica community after the 50-year term of the negotiated agreement had expired. We never heard back from the District about either issue, so it seems a bit disingenuous to claim that the City "abandoned our collaboration."

Second, as you are fully aware, the City asked for time to have a third-party review the District's financial projections and methodology since the District claimed that its methodology was the only way to accomplish two feasible and independent school districts in the Santa Monica and Malibu communities. We made it clear in both our April 21, 2020 and our June 1, 2020, correspondence that we intended to brief the Malibu City Council before sharing the findings of our review with the District. We knew there would be incredible interest by Malibu residents and we hoped that in-person meetings would resume after the summer. When we realized that in-person meetings were further out than anticipated, we chose to brief the Council on October 12, 2020 during a virtual meeting to facilitate meaningful input from Malibu residents. We followed that Council meeting with a Town Hall meeting that took place on October 28, 2020, further affording Malibu residents an opportunity to ask questions and be heard on the issue of school separation. All of these meetings and briefings have been public and completely transparent.

Third, your statements about the presentation shown at the Malibu City Council meeting are misleading, and your link omitted the **entire presentation**. It is correct that per pupil funding for the two future school districts will not be the same, but that is the case across all of the school districts in the State. On a per pupil basis, the two new school districts will end up with higher per pupil funding than the current SMMUSD because, in addition to the general property taxes, the Santa Monica-generated local taxes (i.e., sales taxes, parcel taxes, joint use, and redevelopment taxes) will all remain with the future Santa Monica USD, boosting their funding far above the average per pupil funding in districts with far less community support. Even with this reality, we tried for two years to come to a reasonable solution that provided the future Santa Monica USD with additional property tax revenue from the Malibu community in an effort to create a form of equity. However, the District refused to consider any methodology that did not result in a permanent redistribution of Malibu property taxes – a formula that could have totaled $4 billion over the proposed 50-year term. This is not an acceptable solution for Malibu residents, as reflected in the City Council's October 12th action.

Finally, the City has always been and remains interested in a thoughtful and strategic plan that will allow for the successful creation of two new school districts. In fact, we understood that one impediment to reaching an agreement was the need to resolve how both new districts would be able to retain their respective parcel taxes, as detailed in your letter dated September 11, 2019. As the parties agreed during negotiations, the City approved a **formal declaration** supporting special legislation to preserve the Measure R parcel tax. However, to the City's surprise, the District's Board declined to approve a formal declaration supporting the special legislation at its March 5, 2020 Board meeting after Board President Kean discouraged the declaration. This was one of the final demonstrations by the District that it was not being forthcoming during our negotiations, thereby prompting the City Council's October 12th action.

The City Council and the residents of Malibu remain committed to an independent and locally controlled Malibu Unified School District. Even though the path of a negotiated agreement did not work, the City still hopes that the District will cooperate as the City pursues its Petition for Reorganization through the LACOE County Committee. In this spirit of cooperation, we ask that you forward our letter to the entities identified below to whom your October 28, 2020 letter was addressed and whose exact identities cannot easily be determined by the City (see list labeled "cc from SMMUSD"). Alternatively, we can request a copy of the distribution list under the California Public Records Act. Please confirm when you have completed this transmission.

Obviously, we all agree it is the interest of both communities to allow for the successful creation of two new school districts. We look forward to working with the District to accomplish this.

Sincerely,

Reva Feldman
City Manager

cc: Mayor Farrer and Honorable Members of the Malibu City Council
Honorable Henry Stern, California State Senate, 27th District
Honorable Ben Allen, California State Senate, 26th District
Honorable Richard Bloom, California State Assembly, 50th District
Honorable Sheila Kuehl, Los Angeles County Board of Supervisors, 3rd District
Mayor Kevin McKeown and Honorable Members of the Santa Monica City Council
Honorable Members of the SMMUSD Board of Education
Dr. Allison Deegan, Los Angeles County Office of Education (LACOE)
Lane Dilg, Interim City Manager, City of Santa Monica
George Cardona, Interim City Attorney, City of Santa Monica
Kasey Earnest, Executive Director, Malibu Boys & Girls Club
Craig Foster, President, Advocates for Malibu Public Schools (AMPS)
Malibu Facility District Advisory Committee (M-FDAC)
Laurel Rosen, President/CEO, Santa Monica Chamber of Commerce
Santa Monicans for Renter's Rights
Max Arias, Executive Director, Service Employees International Union (SEIU) Local 99
Sarah Braff, President, Santa Monica-Malibu Classroom Teachers Association (SMMCTA)
Linda Greenburg, Executive Director, Santa Monica Education Foundation
Gabrielle Cohen, President, Santa Monica-Malibu PTA (SMMPTA) Council
City of Malibu Media

cc from SMMUSD:
SMMUSD Parents
SMMUSD Staff
SMMUSD Financial Oversight Committee
Santa Monica Facility District Advisory Committee (SM-FDAC)
SMMUSD District Advisory Committees/DELAC
SMMUSD Community Email List
Samohi Puenta
AAPSSG
Media

Understanding California's Property Taxes

MAC TAYLOR • LEGISLATIVE ANALYST • NOVEMBER 29, 2012

LAO

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EXECUTIVE SUMMARY

The various taxes and charges on a California property tax bill are complex and often not well understood. This report provides an overview of this major source of local government revenue and highlights key policy issues related to property taxes and charges.

A Property Tax Bill Includes a Variety of Different Taxes and Charges. A typical California property tax bill consists of many taxes and charges including the 1 percent rate, voter-approved debt rates, parcel taxes, Mello-Roos taxes, and assessments. This report focuses primarily on the 1 percent rate, which is the largest tax on the property tax bill and the only rate that applies uniformly across every locality. The taxes due from the 1 percent rate and voter-approved debt rates are based on a property's assessed value. The California Constitution sets the process for determining a property's taxable value. Although there are some exceptions, a property's assessed value typically is equal to its purchase price adjusted upward each year by 2 percent. Under the Constitution, other taxes and charges may not be based on the property's value.

The Property Tax Is One of the Largest Taxes Californians Pay. In some years, Californians pay more in property taxes and charges than they do in state personal income taxes, the largest state General Fund revenue source. Local governments collected about $43 billion in 2010-11 from the 1 percent rate. The other taxes and charges on the property tax bill generated an additional $12 billion.

The Property Tax Base Is Diverse. Property taxes and charges are imposed on many types of property. For the 1 percent rate, owner-occupied residential properties represent about 39 percent of the state's assessed value, followed by investment and vacation residential properties (34 percent) and commercial properties (28 percent). Certain properties—including property owned by governments, hospitals, religious institutions, and charitable organizations—are exempt from the 1 percent property tax rate.

All Revenue From Property Taxes Is Allocated to Local Governments. Property tax revenue remains within the county in which it is collected and is used exclusively by local governments. State laws control the allocation of property tax revenue from the 1 percent rate to more than 4,000 local governments, with K-14 districts and counties receiving the largest amounts. The distribution of property tax revenue, however, varies significantly by locality.

The Property Tax Has a Significant Effect on the State Budget. Although the property tax is a local revenue source, it affects the state budget due to the state's education finance system—additional property tax revenue from the 1 percent rate for K-14 districts generally decreases the state's spending obligation for education. Over the years, the state has changed the laws regarding property tax allocation many times in order to reduce its costs for education programs or address other policy interests.

The State's Current Property Tax Revenue Allocation System Has Many Limitations. The state's laws regarding the allocation of property tax revenue from the 1 percent rate have evolved over time through legislation and voter initiatives. This complex allocation system is not well understood, transparent, or responsive to modern local needs and preferences. Any changes to the existing system, however, would be very difficult.

California's Property Tax System Has Strengths and Limitations. Economists evaluate taxes using five common tax policy criteria—growth, stability, simplicity, neutrality, and equity. The state's property tax system exhibits strengths and limitations when measured against these five criteria. Since 1979, revenue from the 1 percent rate has exceeded growth in the state's economy. Property tax revenue also tends to be less volatile than other tax revenues in California due to the acquisition value assessment system. (Falling real estate values during the recent recession, however, caused some areas of the state to experience declines in assessed value and more volatility than in the past.) Although California's property tax system provides governments with a stable and growing revenue source, its laws regarding property assessment can result in different treatment of similar taxpayers. For example, newer property owners often pay a higher effective tax rate than people who have owned their homes or businesses for a long time. In addition, the property tax system may distort business and homeowner decisions regarding relocation or expansion.

INTRODUCTION

For many California taxpayers, the property tax bill is one of the largest tax payments they make each year. For thousands of California local governments—K-12 schools, community colleges, cities, counties, and special districts—revenue from property tax bills represents the foundation of their budgets.

Although property taxes and charges play a major role in California finance, many elements of this financing system are complex and not well understood. The purpose of this report is to serve as an introductory reference to this key funding source. The report begins by explaining the most common taxes and charges on the property tax bill and how these levies are calculated. It then describes how the funds collected from property tax bills—$55 billion in 2010-11—are distributed among local governments. Last, because California's property taxation system has evoked controversy over the years, the report provides a framework for evaluating it. Specifically, we examine California property taxes relative to the criteria commonly used by economists for reviewing tax systems, including revenue growth, stability, simplicity, neutrality, and equity. The report is followed with an appendix providing further detail about the allocation of property tax revenue.

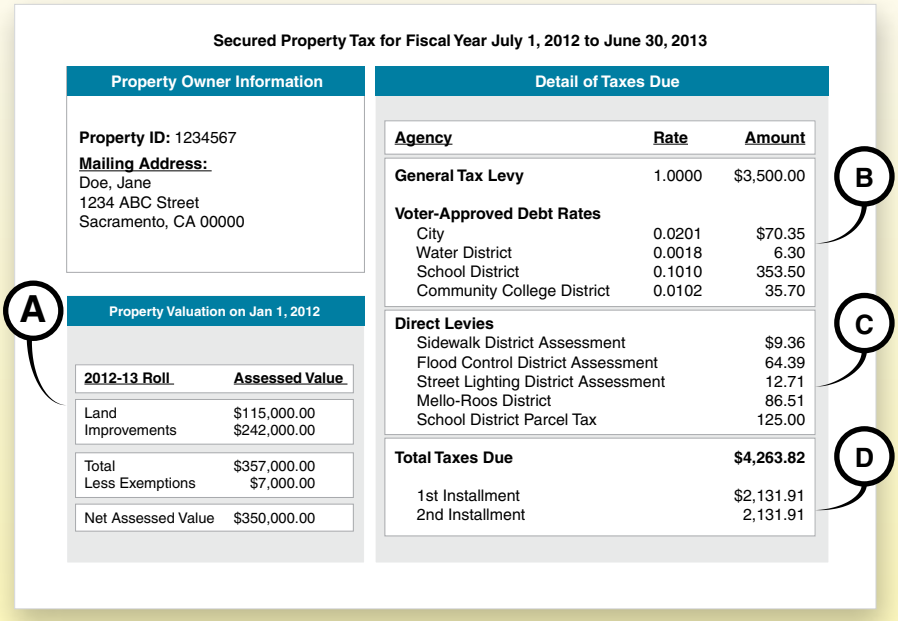
WHAT IS ON THE PROPERTY TAX BILL?

A California property tax bill includes a variety of different taxes and charges. As shown on the sample property tax bill in Figure 1, these levies commonly include:

- The 1 percent rate established by Proposition 13 (1978).
- Additional tax rates to pay for local voter-approved debt.
- Property assessments.
- Mello-Roos taxes.
- Parcel taxes.

The Constitution establishes a process for determining a property's taxable value for purposes of calculating tax levies from the 1 percent rate and voter-approved debt. In our sample property tax bill, "Box A" identifies the taxable value of the property and "Box B" shows the property's tax levies that are calculated based

Figure 1
Sample Annual Property Tax Bill



Secured Property Tax for Fiscal Year July 1, 2012 to June 30, 2013

Property Owner Information

Property ID: 1234567
Mailing Address:
Doe, Jane
1234 ABC Street
Sacramento, CA 00000

Property Valuation on Jan 1, 2012 (A)

2012-13 Roll	Assessed Value
Land	$115,000.00
Improvements	$242,000.00
Total	$357,000.00
Less Exemptions	$7,000.00
Net Assessed Value	$350,000.00

Detail of Taxes Due

Agency	Rate	Amount
General Tax Levy	1.0000	$3,500.00
Voter-Approved Debt Rates		
City	0.0201	$70.35
Water District	0.0018	6.30
School District	0.1010	353.50
Community College District	0.0102	35.70
Direct Levies		
Sidewalk District Assessment		$9.36
Flood Control District Assessment		64.39
Street Lighting District Assessment		12.71
Mello-Roos District		86.51
School District Parcel Tax		125.00
Total Taxes Due		**$4,263.82**
1st Installment		$2,131.91
2nd Installment		2,131.91

(B) (C) (D)

on this value. Levies based on value—such as the 1 percent rate and voter-approved debt rates—are known as "ad valorem" taxes.

Under the Constitution, other taxes and charges on the property tax bill (shown in "Box C") may not be based on the property's taxable value. Instead, they are based on other factors, such as the benefit the property owner receives from improvements.

As shown in "Box D," the total amount due on most property tax bills is divided into two equal amounts. The first payment is due by December 10 and the second payment is due by April 10.

HOW ARE PROPERTY TAXES AND CHARGES DETERMINED?

Ad valorem property taxes—the 1 percent rate and voter-approved debt rates—account for nearly 90 percent of the revenue collected from property tax bills in California. Given their importance, this section begins with an overview of ad valorem taxes and describes how county assessors determine property values. Later in the chapter, we discuss the taxes and charges that are determined based on factors *other* than property value.

Taxes Based on Property Value

The 1 Percent Rate. The largest component of most property owners' annual property tax bill is the 1 percent rate—often called the 1 percent general tax levy or countywide rate. The Constitution limits this rate to 1 percent of assessed value. As shown on our sample property tax bill, the owner of a property assessed at $350,000 owes $3,500 under the 1 percent rate. The 1 percent rate is a general tax, meaning that local governments may use its revenue for any public purpose.

Voter-Approved Debt Rates. Most tax bills also include additional ad valorem property tax rates to pay for voter-approved debt. Revenue from these taxes is used primarily to repay general obligation bonds issued for local infrastructure projects, including the construction and rehabilitation of school facilities. (As described in the nearby box, some voter-approved rates are used to pay obligations approved by local voters before 1978.) Bond proceeds may not be used for general local government operating expenses, such as teacher salaries and administrative costs. Most local governments must obtain the approval of two-thirds of their local voters in order to issue general obligation bonds repaid with debt rates. General obligation bonds for school and community college facilities, however, may be approved by 55 percent of the school or community college district's voters. Local voters do not approve a fixed tax rate for general obligation bond indebtedness. Instead, the rate adjusts annually so that it raises the amount of money needed to pay the bond costs.

Property tax bills often include more than one voter-approved debt rate. In our sample property tax bill, for example, the property owner is subject to four additional rates because local voters have approved bond funds for the city and water, school, and community college districts where the property is located. These rates tend to be a small percentage of assessed value. Statewide, the average property tax bill includes voter-approved debt rates that total about one-tenth of 1 percent of assessed value.

Calculating Property Value for Ad Valorem Taxes

One of the first items listed on a property tax bill is the assessed value of the land and improvements. Assessed value is the taxable value of the property, which includes the land and any improvements made to the land, such as buildings, landscaping, or other developments. The assessed value of land and improvements is important because the 1 percent rate and voter-approved debt rates are levied as a percentage of this value, meaning that properties with higher assessed values owe higher property taxes.

Debt Approved by Voters Prior to 1978

The California Constitution allows local governments to levy voter-approved debt rates—ad valorem rates above the 1 percent rate—for two purposes. The first purpose is to pay for indebtedness approved by voters prior to 1978, as allowed under Proposition 13 (1978). Proposition 42 (1986) authorized a second purpose by allowing local governments to levy additional ad valorem rates to pay the annual cost of general obligation bonds approved by voters for local infrastructure projects. Because most debt approved before 1978 has been paid off, most voter-approved debt rates today are used to repay general obligation bonds issued after 1986 as authorized under Proposition 42.

Some local governments, however, continue to levy voter-approved debt rates for indebtedness approved by voters before 1978. While most bonds issued before the passage of Proposition 13 have been paid off, state courts have determined that other obligations approved by voters before 1978 also can be paid with an additional ad valorem rate. Two common pre-1978 obligations paid with voter-approved debt rates are local government employee retirement costs and payments to the State Water Project.

Voter-Approved Retirement Benefits. Voters in some counties and cities approved ballot measures or city charters prior to 1978 that established retirement benefits for local government employees. The California Supreme Court ruled that such pension obligations represent voter-approved indebtedness that could be paid with an additional ad valorem rate. Local governments may levy the rate to cover pension benefits for any employee, including those hired after 1978, but not to cover any enhancements to pension benefits enacted after 1978. Local governments may adjust the rate annually to cover employee retirement costs, but state law limits the rate to the level charged for such purposes in 1982-83 or 1983-84, whichever is higher. A recent review shows that at least 20 cities and 1 county levy voter-approved debt rates to pay some portion of their annual pension costs. The rates differ by locality. For example, the City of Fresno's voter-approved debt rate for employee retirement costs is 0.03 percent of assessed value in 2012-13, while the City of San Fernando's rate is 0.28 percent.

State Water Project Payments. Local water agencies can levy ad valorem rates above the 1 percent rate to pay their annual obligations for water deliveries from the State Water Project. State courts concluded that such costs were voter-approved debt because voters approved the construction, operation, and maintenance of the State Water Project in 1960. As a result, most water agencies that have contracts with the State Water Project levy a voter-approved debt rate.

Under California's tax system, the assessed value of most property is based on its purchase price. Below, we describe the process county assessors use to determine the value of local "real property" (land, buildings, and other permanent structures). This is followed by an explanation of how assessors determine the value of "personal property" (property not affixed to land or structures, such as computers, boats, airplanes, and business equipment) and "state assessed property" (certain business properties that cross county boundaries).

Local Real Property Is Assessed at Acquisition Value and Adjusted Upward Each Year. The process that county assessors use to determine the value of real property was established by Proposition 13. Under this system, when real property is purchased, the county assessor assigns it an assessed value that is equal to its purchase price, or "acquisition value." Each year thereafter, the property's assessed value increases by 2 percent or the rate of inflation, whichever is lower. This process continues until the property is sold, at which point the county assessor again assigns it an assessed value equal to its most recent purchase price. In other words, a property's assessed value resets to market value (what a willing buyer would pay for it) when it is sold. (As shown in Figure 2, voters have approved various constitutional amendments that exclude certain property transfers from triggering this reassessment.)

In most years, under this assessment practice, a property's market value is greater than its assessed value. This occurs because assessed values increase by a maximum of 2 percent per year, whereas market values tend to increase more rapidly. Therefore, as long as a property does not change ownership, its assessed value increases predictably from one year to the next and is unaffected by higher annual increases in market value. For example, Figure 3 shows how a hypothetical property purchased in 1995 for $185,000 would

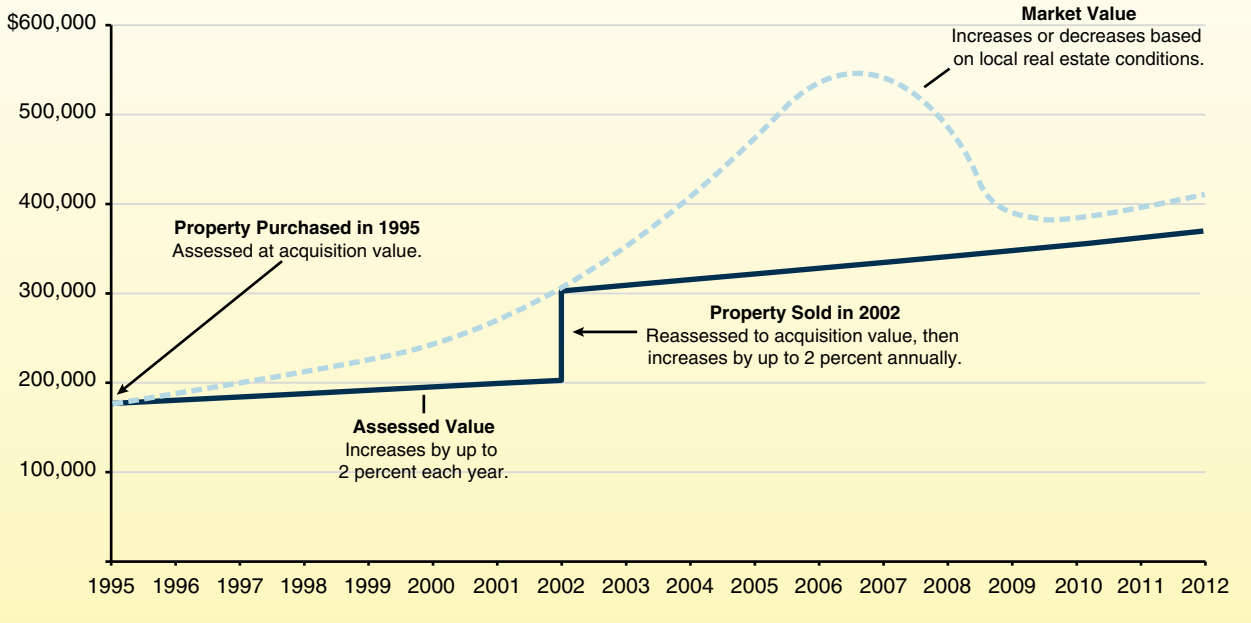
Figure 2

Property Transfers That Do Not Trigger Reassessment

Proposition	Year	Description
3	1982	Allows property owners whose property has been taken by eminent domain proceedings to transfer their existing assessed value to a new property of similar size and function.
50	1986	Allows property owners whose property has been damaged or destroyed in a natural disaster to transfer their existing assessed value to a comparable replacement property within the same county.
58	1986	Excludes property transfers between spouses or between parents and children from triggering reassessment.
60	1986	Allows homeowners over the age of 55 to transfer their existing assessed value to a new home, of equal or lesser market value, within the same county.
90	1988	Extends Proposition 60 by allowing homeowners to transfer their existing assessed value to a new home, of equal or lesser market value, in a different participating county.
110	1990	Allows disabled homeowners to transfer their existing assessed value from an existing home to a newly purchased home of equal or lesser market value.
171	1993	Extends Proposition 50 by allowing property owners affected by a natural disaster to transfer their existing assessed value to a comparable replacement property in a different participating county.
193	1996	Excludes property transfers between grandparents and grandchildren (when the parents are deceased) from triggering reassessment.
1	1998	Allows property owners whose property is made unusable by an environmental problem to transfer their existing assessed value to a comparable replacement property.

Figure 3

Market Value Can Exceed Assessed Value



be assessed in 2012. Although the market value of the property increased to $300,000 by 2002, the assessed value was $200,000 because assessed value grew by only up to 2 percent each year. Upon being sold in 2002, the property's assessed value reset to a market value of $300,000. Because of the large annual increase in home values after 2002, however, the market value was soon much greater than the assessed value for the new owner as well.

Property Improvements Are Assessed Separately. When property owners undertake property improvements, such as additions, remodeling, or building expansions, the additions or upgrades are assessed at market value in that year and increase by up to 2 percent each year thereafter. The unimproved portion of the property continues to be assessed based on its original acquisition value. For example, if a homeowner purchased a home in 2002 and then added a garage in 2010, the home and garage would be assessed separately. The original property would be assessed at its 2002 acquisition value adjusted upward each year while the garage would be assessed at its 2010 market value adjusted upward. The property's assessed value would be the combined value of the two portions. (As shown in Figure 4, voters have excluded certain property improvements from increasing the assessed value of a property.)

Figure 4

Property Improvements That Do Not Increase a Property's Assessed Value

Constitutional Amendments Approved After June 1978

Proposition	Year	Type of Improvement
8	1978	Reconstruction following natural disaster
7	1980	Solar energy construction
31	1984	Fire-safety improvements
110	1990	Accessibility construction for disabled homeowners
177	1994	Accessibility construction for any property
1	1998	Reconstruction following environmental contamination
13	2010	Seismic safety improvements

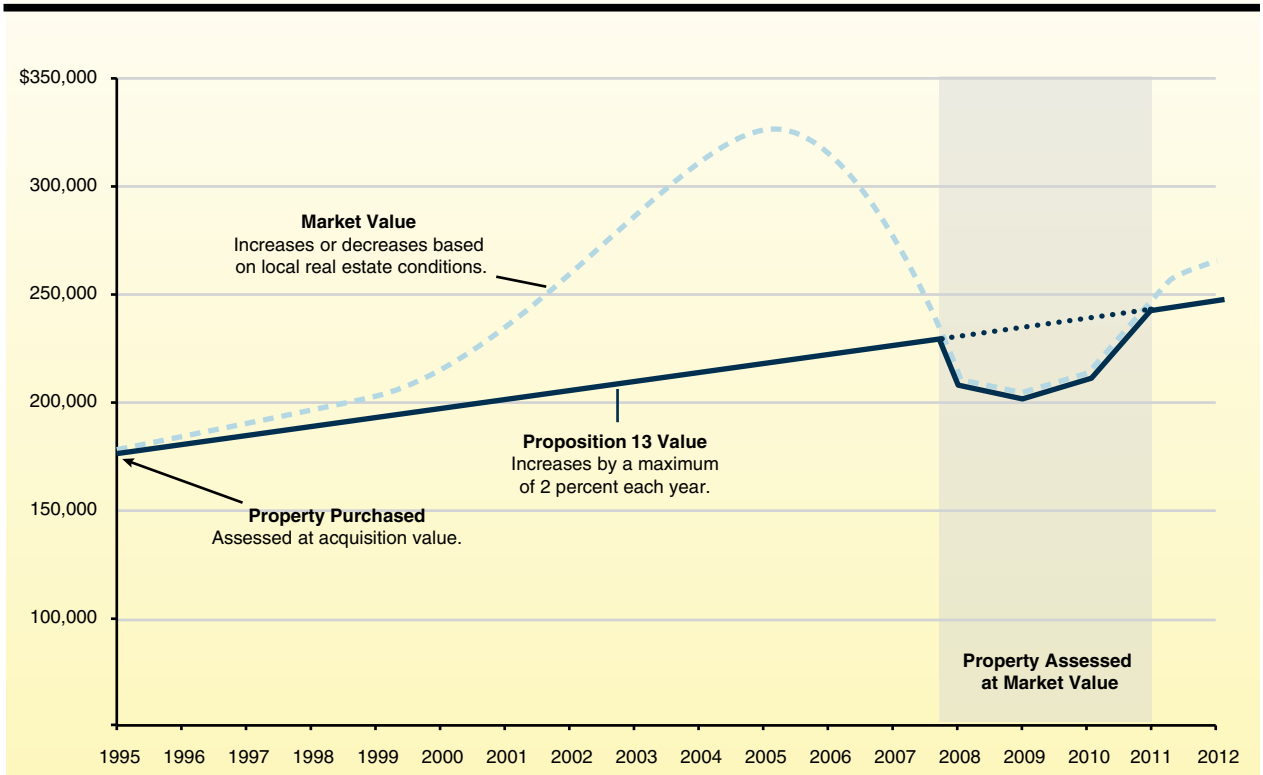
Assessed Value May Be Reduced When Market Values Fall Significantly. When real estate values decline or property damage occurs, a property's market value may fall below its assessed value as set by Proposition 13. Absent any adjustment to this assessed value, the property would be taxed at a greater value than it is worth.

In these events, county assessors may automatically reduce the Proposition 13 assessed value of a property to its current market value. If they do not, however, a property owner may petition the assessor to have his or her assessed value reduced. These decline-in-value properties are often called "Prop 8 properties" after Proposition 8 (1978), which authorizes this assessment reduction to market value. Figure 5 illustrates the assessment of a hypothetical decline-in-value property over time. The market value of the property purchased in 1995 stays above its Proposition 13 assessed value through 2007. A significant decline, however, drops the property's market value below its Proposition 13 assessed value. At this time, the property receives a decline-in-value assessment (equal to its market value) that is less than its Proposition 13 assessment. For three years, the property is assessed at market value, which may increase or decrease by any amount. By 2012, the property's market value *once again exceeds* what its assessed value would have been absent Proposition 8 (acquisition price plus the 2 percent maximum annual increase). In subsequent years, the property's assessed value is determined by its acquisition price adjusted upward each year.

Homeowners Are Eligible for a Property Tax Exemption. Homeowners may claim a $7,000 exemption from the assessed value of their primary residence each year. As shown in "Box A" of the sample property tax bill in Figure 1, this exemption lowers the assessed value of the homeowner's land and improvements by $7,000, reducing taxes under the

Figure 5

Assessed Value Can Fall Below Proposition 13 Value



1 percent rate by $70 and reducing taxes from voter-approved debt rates by a statewide average of $8.

Two Types of Property Are Assessed at Their Market Value. Two categories of property are assessed at their current market value, rather than their acquisition value: personal property and state-assessed property. (We provide more information about these properties in the nearby box.) Combined, these types of properties accounted for 6 percent of statewide-assessed value in 2011-12. Most personal property and state-assessed property is taxed at the 1 percent rate plus any additional rates for voter-approved debt.

Determining Other Taxes and Charges

All other taxes and charges on the property tax bill are calculated based on factors other than the property's assessed value. For example, some levies are based on the cost of a service provided to the property. Others are based on the size of a parcel, its square footage, number of rooms, or other characteristics. Below, we discuss three of the most common categories of non-ad valorem levies: assessments, parcel taxes, and Mello-Roos taxes. In addition to these three categories, some local governments collect certain fees for service on property tax bills, such as charges to clear weeds on properties where the weeds present a fire safety hazard. These fees are diverse and relatively minor, and therefore are not examined in this report.

Assessments. Local governments levy assessments in order to fund improvements that benefit real property. For example, with the approval of affected property owners, a city or county may create a street lighting assessment district to fund the construction, operation, and maintenance of street lighting in an area. Under Proposition 218 (1996), improvements funded with assessments must provide a direct benefit to the property owner. An assessment typically cannot be levied for facilities or services that provide general public benefits, such as schools, libraries, and public safety, even

Properties Assessed at Current Market Value

Personal Property. Personal property is property other than land, buildings, and other permanent structures, which are commonly referred to as "real property." Most personal property is exempt from property taxation, including business inventories, materials used to manufacture products, household furniture and goods, personal items, and intangible property like gym memberships and life insurance policies. Some personal property, however, is subject to the property tax. These properties consist mainly of manufacturing equipment, business computers, planes, commercial boats, and office furniture. When determining the market value of personal property, county assessors take into account the loss in value due to the age and condition of personal property—a concept known as depreciation. Unlike property taxes on real property, which are due in two separate payments, taxes on personal property are due on July 3.

State-Assessed Property. The State Board of Equalization is responsible for assessing certain real properties that cross county boundaries, such as pipelines, railroad tracks and cars, and canals. State-assessed properties are assessed at market value and, with the exception of railroad cars, taxed at the 1 percent rate plus any additional rates for voter-approved debt. (As part of a federal court settlement decades ago, railroad cars are taxed at a rate that is somewhat lower than 1 percent. The railcar tax rate varies each year and currently is about 0.8 percent.)

though these programs may increase the value of property. Moreover, the amount each property owner pays must reflect the cost incurred by the local government to provide the improvement and the benefit the property receives from it. To impose a new assessment, a local government must secure the approval of a weighted majority of affected property owners, with each property owner's vote weighted in proportion to the amount of the assessment he or she would pay.

Parcel Taxes. With the approval of two-thirds of voters, local governments may impose a tax on all parcels in their jurisdiction (or a subset of parcels in their jurisdiction). Local governments typically set parcel taxes at fixed amounts per parcel (or fixed amounts per room or per square foot of the parcel). Unlike assessments, parcel tax revenue may be used to fund a variety of local government services, even if the service does not benefit the property directly. For example, school districts may use parcel tax revenue to pay teacher salaries or administrative costs. The use of parcel tax revenue, however, is restricted to the public programs, services, or projects that voters approved when enacting the parcel tax.

Mello-Roos Taxes. Mello-Roos taxes are a flexible revenue source for local governments because they (1) may be used to fund infrastructure projects or certain services; (2) may be levied in proportion to the benefit a property receives, equally on all parcels, by square footage, or by other factors; and (3) are collected within a geographical area drawn by local officials.

Local governments often use Mello-Roos taxes to pay for the public services and facilities associated with residential and commercial development. This occurs because landowners may approve Mello-Roos taxes by a special two-thirds vote—each owner receiving one vote per acre owned—when fewer than 12 registered voters reside in the proposed district. In this way, a developer who owns a large tract of land could vote to designate it as a Mello-Roos district. After the land is developed and sold to residential and commercial property owners, the new owners pay the Mello-Roos tax that funds schools, libraries, police and fire stations, or other public facilities and services in the new community. Mello-Roos taxes are subject to two-thirds voter approval when there are 12 or more voters in the proposed district.

WHAT PROPERTIES ARE TAXED?

Property taxes and charges are imposed on many types of properties. These properties include common types such as owner-occupied homes and commercial office space, as well as less common types like timeshares and boating docks. In the section below, we describe the state's property tax base—the types of real properties that are subject to the 1 percent rate and the share of total assessed value that each property type represents.

Due to data limitations, we do not summarize the tax bases of other taxes and charges. We note, however, that the property tax base for other taxes and charges is different from the tax base for the 1 percent rate. This is because the 1 percent rate applies uniformly to all taxable real property, whereas other taxes and charges are levied at various levels and on various types of property throughout the state (according to local voter or local government preferences). For example, if a suburban school district levies a parcel tax on each parcel in a residential area, the owners of single-family homes would pay a large share of the total parcel taxes. Accordingly, the school district's parcel tax base would be more heavily residential

than the statewide property tax base under the 1 percent rate (which applies to all taxable property).

What Properties Are Subject to the 1 Percent Rate?

Although most real property is taxable, the Constitution exempts certain types of real property from taxation. In general, these are government properties or properties that are used for non-commercial purposes, including hospitals, religious properties, charities, and nonprofit schools and colleges. California properties that are subject to the property tax, however, can be classified in three ways:

- Owner-occupied residential—properties that receive the state's homeowner's exemption, which homeowners may claim on their primary residence.
- Investment and vacation residential—residential properties other than those used as a primary residence, including multifamily apartments, rental condominiums, rental homes, vacant residential land, and vacation homes.
- Commercial—retail properties, industrial plants, farms, and other income-producing properties.

Distribution of the Tax Base for the 1 Percent Rate

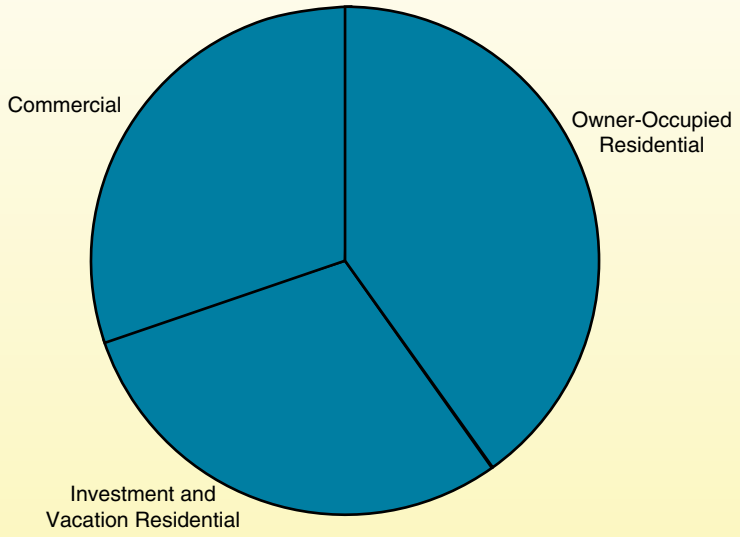
Owner-Occupied Residential. In 2010-11, there were 5.5 million owner-occupied homes in California with a total assessed value of $1.6 trillion. As shown in Figure 6, owner-occupied residential properties accounted for the largest share—39 percent—of the state's tax base for the 1 percent rate.

Investment and Vacation Residential. Although the majority of residential properties are owner occupied, many others are investment or vacation properties such as multifamily apartments, rental condominiums, rental homes, vacant residential land, and vacation homes. (We classify vacant residential land and vacation homes as investment properties because they are an investment asset for the owner, even if he or she does not receive current income from them.) In 2010-11, there were 4.2 million investment and vacation residential properties. The assessed value

Figure 6

The Distribution of California's Property Tax Base

Share of Assessed Value for Properties Subject to the 1 Percent Rate[a], 2010-11



[a] Excludes personal property and state-assessed property.

of these properties was about $1.4 trillion, which represents 34 percent of the state's total assessed value.

Commercial. In 2010-11, there were approximately 1.3 million commercial properties in California. This amount includes about 600,000 retail, industrial, and office properties (such as stores, gas stations, manufacturing facilities, and office buildings). It also includes 500,000 agricultural properties and 200,000 other properties (gas, oil, and mineral properties and the private use of public land). While commercial properties represent a relatively small share of the state's total properties, they tend to have higher assessed values than other properties. Therefore, as shown in Figure 6, these properties (which have a total assessed value of $1.2 trillion) account for 28 percent of the state's property tax base.

Has the Distribution of the Property Tax Base Changed Over Time?

There is little statewide information regarding the composition of California's property tax base over time. Based on the available information, however, it appears that homeowners may be paying a larger percentage of total property taxes today than they did decades ago. We note, for example, that the assessed value of owner-occupied homes has increased from a low of 32 percent of statewide assessed valuation in 1986-87 to a high of 39 percent in 2005-06. (The share was 36 percent in 2011-12.) It also appears likely that owners of commercial property are paying a smaller percentage of property taxes than they did decades ago. For example, Los Angeles County reports that the share of total assessed value represented by commercial property in the county declined from 40 percent in 1985 to 30 percent in 2012. In addition, the assessed value of commercial property in Santa Clara County has declined (as a share of the county total) from 29 percent to 24 percent since 1999-00.

What Factors May Have Contributed to Changes in the Property Tax Base?

Various economic changes that have taken place over time probably have contributed to changes to California's property tax base. For example, investment in residential property has increased significantly since the mid-1970s. Newly built single-family homes have become larger and are more likely to have valuable amenities than homes built earlier. As a result, new homes are more expensive to build and assessed at higher amounts than older homes. Over the same period, commercial activity in California has shifted away from traditional manufacturing, which tends to rely heavily on real property. Newer businesses, on the other hand, are more likely to be technology and information services based. These businesses tend to own less real property than traditional manufacturing firms do. (Technology and information services firms, however, rely heavily on business personal property—for example, computing systems, design studios, and office equipment—that are taxed as personal property and not included in the distribution of the state's real property tax base.)

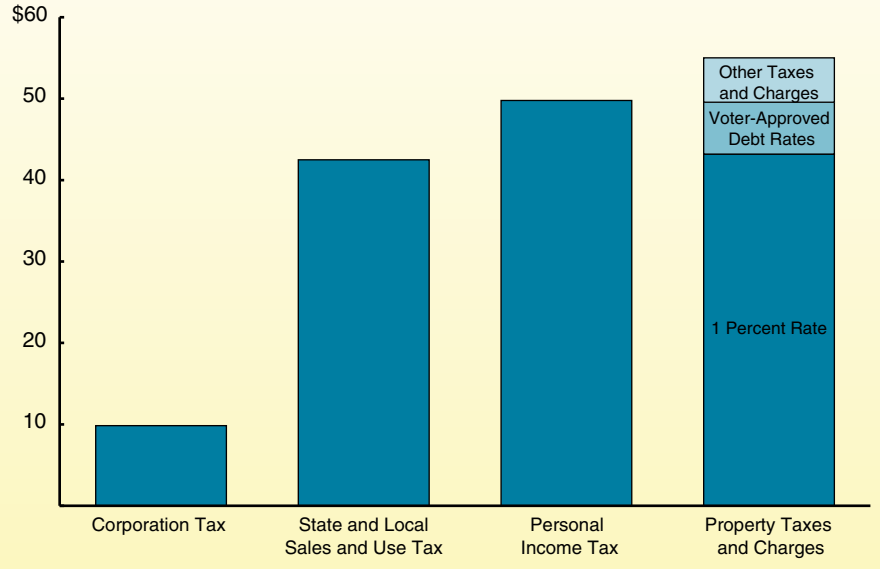
It also is possible that Proposition 13's acquisition value assessment system has played a role in the changes to California's tax base. Specifically, under Proposition 13, properties that change ownership more frequently tend to be assessed more closely to market value than properties that turn over less frequently. (Because properties are assessed to market value when they change ownership, properties that have not changed ownership in many years tend to have larger gaps between their assessed values and market values.) It is possible that some categories of properties change ownership more frequently than others and this could influence the composition of the overall tax base. The limited available research suggests that investment and vacation

residential properties change ownership more frequently than commercial or owner-occupied residential property, indicating that they may be assessed closer to market value than other types of property.

Figure 7

Property Tax Revenue Compared With Other Major Revenue Sources

2010-11 (In Billions)



How Much Revenue Is Collected?

In 2010-11, California property tax bills totaled $55 billion. As shown in Figure 7, this amount included $43.2 billion under the 1 percent rate and $5.7 billion from voter-approved debt rates, making ad valorem property taxes one of California's largest revenue sources.

Comparatively little is known about the remaining $6 billion of other taxes and charges on the property tax bill. From various reports summarizing local government finances, elections, and bond issuances, it appears that most of this $6 billion reflects property assessments, parcel taxes, and Mello-Roos taxes, though statewide data are not available on the exact amounts collected for each of these funding sources.

HOW IS THE REVENUE DISTRIBUTED?

California property owners pay their property tax bills to their county tax collector (sometimes called the county treasurer-tax collector). The funds are then transferred to the county auditor for distribution. The county auditor distributes the funds collected from the 1 percent rate differently than the funds collected from the other taxes and charges on the bill. Specifically, the 1 percent rate is a shared revenue source for multiple local governments.

This section describes the distribution of revenue raised under the 1 percent rate and summarizes the limited available information regarding the distribution of voter-approved debt rates and non-ad valorem property taxes and charges.

Revenue From the 1 Percent Rate Is Shared by Many Local Governments

The 1 percent rate generates most of the revenue from the property tax bill—roughly

$43 billion in 2010-11. On a typical property tax bill, however, the 1 percent rate is listed as the general tax levy or countywide rate with no indication as to which local governments receive the revenue or for what purpose the funds are used. In general, county auditors allocate revenue from the 1 percent rate to a variety of local governments within the county pursuant to a series of complex state statutes.

More Than 4,000 Local Governments Receive Revenue From the 1 Percent Rate. All property tax revenue remains within the county in which it is collected to be used exclusively by local governments. As shown in Figure 8, property tax revenue from the 1 percent rate is distributed to counties, cities, K-12 schools, community college districts, and special districts. Until recently, redevelopment agencies also received property tax revenue. As described in the nearby box, redevelopment agencies were dissolved in 2012, but a large amount of property tax revenue continues to be used to pay the former agencies' debts and obligations.

Figure 8

How Many Local Governments Receive Revenue From the 1 Percent Rate?

Type of Local Government	Number
Counties	58
Cities	480
Schools and Community Colleges	
K-12 school districts	966
County Offices of Education	56
Community college districts	72
Special Districts	
Fire protection	348
County service area	316
Cemetery	241
Community services	201
Maintenance	136
Highway lighting	117
County water	100
Recreation and park	85
Hospital	64
Sanitary	60
Irrigation	46
Mosquito abatement	43
Public utility	43
Other[a]	400
Redevelopment Agencies[b]	422
Total	**4,254**

[a] Thirty three other types of special districts report receiving property tax revenue from the 1 percent rate. These include county sanitation, municipal water, memorial, water authority, drainage, and library districts.

[b] Dissolved in 2012. A portion of property tax revenue continues to pay these agencies' debts and obligations.

Figure 9 shows the share of revenue received by each type of local government from the 1 percent rate and voter-approved debt rates. (As described later in the report, however, these shares vary significantly by locality.)

Property Taxes Also Affect the State Budget. Although the state does not receive any property tax revenue directly, the state has a substantial fiscal interest in the distribution of property tax revenue from the 1 percent rate because of the state's education finance system. Each K-12 district receives "revenue limit" funding—the largest source of funding for districts—from the combination of local property tax revenue under the 1 percent rate and state resources. Thus, if a K-12 district's local property tax revenue is not sufficient to meet its revenue limit, the state provides additional funds. Community colleges have a similar financing system, in which each district receives apportionment funding from local property tax revenue, student fees, and state resources. In 2010-11, the state contributed $22.5 billion to K-12 revenue limits and community college apportionments, while the remainder ($14.5 billion) came from local property tax revenue (and student fees).

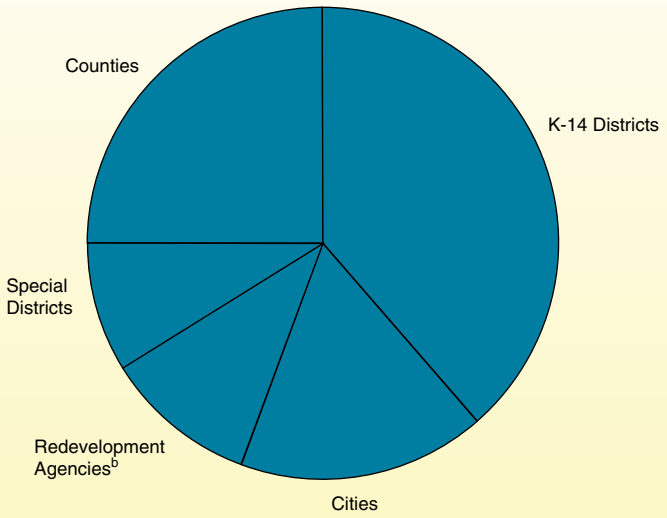
State Laws Direct Allocation of Revenue From the 1 Percent Rate. The county auditor is responsible for allocating revenue generated from the 1 percent rate to local governments pursuant to state law. The allocation system is commonly referred to as "AB 8," after the bill that first

implemented the system—Chapter 282, Statutes of 1979 (AB 8, L. Greene). In general, AB 8 provides a share of the total property taxes collected within a community to each local government that provides services within that community. Each local government's share is based on its proportionate countywide share of property taxes during the mid-1970s, a time when each local government determined its own property tax rate and property owners paid taxes based on the sum of

Figure 9

Most Ad Valorem Property Tax Revenue Is Allocated to Schools and Counties[a]

2010-11



[a] As a percentage of total revenue from the 1 percent rate and voter-approved debt rates.

[b] Redevelopment agencies were dissolved in 2012. Successor agencies will continue to use property tax revenue to pay former agencies' debts and obligations.

Redevelopment and Successor Agencies

More than 60 years ago, the Legislature established a process whereby a city or county could declare an area to be blighted and in need of redevelopment. After this declaration, most property tax revenue growth from the redevelopment "project area" was distributed to the redevelopment agency, instead of the other local governments serving the project area. As discussed in our report, *The 2012-13 Budget: Unwinding Redevelopment*, redevelopment agencies were dissolved in February 2012. Prior to their dissolution, however, redevelopment agencies received over $5 billion in property tax revenue annually. These monies were used to pay off tens of billions of dollars of outstanding bonds, contracts, and loans.

In most cases, the city or county that created the redevelopment agency is managing its dissolution as its successor agency. The successor agency manages redevelopment projects currently underway, pays existing debts and obligations, and disposes of redevelopment assets and properties. The successor agency is funded from the property tax revenue that previously would have been distributed to the redevelopment agency. As a result, even though redevelopment agencies have been dissolved, some property tax revenue continues to be used to pay redevelopment's debts and obligations. Over time, most redevelopment obligations will be retired and the property tax revenue currently distributed to successor agencies will be distributed to K-14 districts, counties, cities, and special districts.

these rates. (The average property tax rate totaled about 2.7 percent.) As a result, local governments that received a large share of property taxes in the 1970s typically receive a relatively large share of revenue from the 1 percent rate under AB 8. (More detail on the history of the state's property tax allocation system—including AB 8—is provided in the appendix of this report.)

Revenue Allocated by Tax Rate Area (TRA). The county auditor allocates the revenue to local governments by TRA. A TRA is a small geographical area within the county that contains properties that are all served by a unique combination of local governments—the county, a city, and the same set of special districts and school districts. A single county may have thousands of TRAs. While there is considerable variation in the steps county auditors use to allocate revenue within each TRA, typically the county auditor annually determines how much revenue was collected in each TRA and first allocates to each local government in the TRA the same amount of revenue it received in the prior year. Each local government then receives a share of any growth (or loss) in revenue that occurred within the TRA that year. Each TRA has a set of growth factors that specify the proportion of revenue growth that goes to each local government. These factors—developed by county auditors pursuant to AB 8—are largely based on the share of revenue each local government received from the TRA during the late 1970s.

Figure 10 shows sample growth factors for TRAs in two California cities. As the figure indicates, 23 percent of any growth in revenue from the 1 percent rate in the sample TRA for Norwalk would be allocated to the county, 7 percent would go to the city, and the rest would be allocated to various educational entities and special districts. The percentage of property tax growth allocated to each type of local government can vary significantly by TRA. For example, Walnut Creek's K-12 school district receives 33 percent of the growth in revenue within its TRA while Norwalk's school district receives only 19 percent from its TRA. As noted above, this variation is based largely on historical factors specified in AB 8.

Some Revenue Is Allocated to a Countywide Account—ERAF. Most of the revenue from the 1 percent rate collected within a TRA is allocated to the city, county, K-14 districts, and special districts that serve the properties in that TRA. State law, however, directs the county auditor to shift a portion of this revenue to a countywide account that is distributed to other local governments that do not necessarily serve the taxed properties. The state originally established this account—the Educational Revenue Augmentation Fund (ERAF)—to provide additional funds to K-14 districts that do not receive sufficient property tax revenue to meet their minimum funding level. State laws later expanded the use of ERAF to include reimbursing cities and counties for the loss of other local revenue sources (the vehicle license fee and sales tax) due to changes in state policy. For example, Figure 10 shows that 20 percent of any revenue growth within Norwalk's TRA is deposited into ERAF. It is possible that some or all of this revenue could be allocated to a city or K-14 district in a different part of Los Angeles County.

Most Revenue From Voter-Approved Debt Distributed to Schools

Voter-approved debt rates are levied on property owners so that local governments can pay the debt service on voter-approved general obligation bonds (and pre-1978 voter-approved obligations). The state's K-12 school districts receive the majority of the revenue from voter-approved debt rates ($3.1 billion of $5.2 billion in 2009-10). The amount received by cities ($520 million), special districts ($470 million), and counties

($320 million) is significantly less. The amount of taxes collected to pay voter-approved debt varies considerably across the state. For example, the average amount paid by an Alameda County property owner for voter-approved debt rates is about $2 for each $1,000 of assessed value, while the average amount paid in some counties is less than 10 cents per $1,000 of assessed value.

Limited Information About Distribution Of Other Property Taxes and Charges

Less information is available about the statewide distribution of the revenue from parcel taxes, Mello-Roos taxes, and assessments.

Parcel Taxes. Recent election reports and financial data suggest that parcel taxes represent a significant and growing source of revenue for some local governments. Specifically, between 2001 and 2012, local voters approved about 180 parcel tax measures to fund cities, counties, and special districts, and about 135 measures to fund K-12 districts. The most recent K-12 financial data (2009-10) indicate that schools received about $350 million from this source. We were not able to locate information on the statewide amount of parcel tax revenue collected by cities, counties, and special districts.

Mello-Roos Taxes. Mello-Roos districts are required to report on their bond issuance, which

Figure 10

Allocation of Property Tax Growth in Sample Tax Rate Areas

Norwalk, Los Angeles County[a]	Percent Share
Los Angeles County	23%
Educational Revenue Augmentation Fund	20
Norwalk-La Mirada Unified School District	19
Los Angeles County Fire Protection District	18
City of Norwalk	7
Norwalk Parks and Recreation District	3
Los Angeles County Library	2
La Mirada Parks and Recreation District	2
Cerritos Community College District	2
Los Angeles County Flood Control District	1
Los Angeles County Sanitation District	1
Greater Los Angeles County Vector Control	—[b]
Water Replenishment District of Southern California	—[b]
Little Lake Cemetery District	—[b]
Los Angeles County Department of Education	—[b]
	100%

Walnut Creek, Contra Costa County[c]	Percent Share
Mount Diablo Unified School District	33%
Educational Revenue Augmentation Fund	17
Contra Costa County	13
Contra Costa County Fire	13
City of Walnut Creek	9
Contra Costa Community College District	5
East Bay Regional Park District	3
Contra Costa County Library	2
Central Contra Costa Sanitary District	2
Contra Costa County Office of Education	1
Contra Costa County Flood Control	1
Bay Area Rapid Transit	1
Contra Costa Water District	1
Contra Costa County Water Agency	—[b]
Contra Costa County Resource Conservation District	—[b]
Contra Costa County Mosquito Abatement District	—[b]
Contra Costa County Service Area R-8	—[b]
Bay Area Air Management District	—[b]
	100%

[a] Percentages indicate allocation of the growth in property taxes in Los Angeles County tax rate area 06764.
[b] Less than 0.5 percent.
[c] Percentages indicate allocation of the growth in property taxes in Contra Costa County tax rate area 09025.

provides some information about the types of local governments that receive Mello-Roos tax revenue. It is likely that local governments issuing a large amount of Mello-Roos bonds also are collecting a large amount of Mello-Roos tax revenue. Between 2004 and 2011, cities issued about 50 percent of the bonds issued by Mello-Roos districts in California, followed by K-12 districts at about 30 percent. During the same time period, the issuance of Mello-Roos bonds was concentrated in specific regions, as more than 60 percent of the bonds were issued by local governments in four counties—Riverside, Orange, San Diego, and Placer.

Assessments. Most of the property improvements funded by assessments are provided by cities and special districts. In 2009-10, cities and special districts reported receiving $760 million and $650 million, respectively, in revenue from assessments. In contrast, counties reported $11 million in such revenues.

WHY DO LOCAL GOVERNMENT PROPERTY TAX RECEIPTS VARY?

The share of revenue received by each type of local government from the 1 percent rate varies significantly by locality. County governments, for example, receive as little as 11 percent (Orange) and as much as 64 percent (Alpine) of the ad valorem property tax revenue collected within their county. As shown in Figure 11, revenue raised from the 1 percent rate also varies considerably by locality when measured by revenue per resident. Orange County receives about $175 per resident, while four counties receive more than $1,000 per resident. Although cities, on average, receive about $240 per resident in revenue from the 1 percent rate, some receive more than $500 per resident and many receive less than $150 per resident. School districts also receive widely different amounts of property taxes per enrolled student, with an average of just under $2,000. (As noted above, the state "tops off" school property tax revenue with state funds to bring most schools to similar revenue levels.) Finally, special districts also receive varying amounts of property tax revenue, though data limitations preclude us from summarizing this variation on a statewide basis.

Three factors account for most of this variation in local government property tax receipts. We discuss these factors below.

Variation in Property Values

California has a diverse array of communities with large variation in land and property values. Some communities are extensively developed and have many high-value homes and businesses, whereas others do not. Because property taxes are based on the assessed value of property, communities with greater levels of real estate development tend to receive more property tax revenue than communities with fewer developments. For example, high-density cities generally receive more property tax revenue than rural areas due to the greater level of development. Coastal and resort areas also typically receive more property taxes due to the high property values. Certain high-value properties—such as a power plant or oil refinery—also increase property tax revenue. Alternatively, localities with large amounts of land owned by the federal government, universities, or other organizations that are not required to pay property taxes may receive less revenue.

Prior Use of Redevelopment

Prior decisions by cities and counties to use redevelopment also influences the amount of property tax revenue local governments receive. Prior to the dissolution of redevelopment agencies in 2012, most of the growth in property taxes from redevelopment project areas went to the redevelopment agency, rather than other local governments. A large share of property tax revenue now goes to successor agencies to pay the former redevelopment agencies' debts and obligations. The use of redevelopment varied extensively throughout the state. In those communities with many redevelopment project areas, the share of property tax revenue going to other local governments is less than it would be otherwise. In places with large redevelopment project areas—such as San Bernardino and Riverside counties—more than 20 percent of the county's property tax revenue may go to pay the former redevelopment agencies' debts and obligations.

State Allocation Laws Reflecting 1970s Taxation Levels

Finally, the amount of property taxes allocated to local governments depends on state property tax allocation laws, principally AB 8. As discussed earlier in this report (and in more detail in the appendix), the AB 8 system was designed, in part, to allocate property tax revenue in proportion to the share of property taxes received by a local government in the mid-1970s. Under this system, local governments that received a large share of property taxes in the 1970s typically continue to receive a relatively large share of property taxes today. Although there have been changes to the original property tax allocation system contained in AB 8, the allocation system continues to be substantially based on the variation in property tax receipts in effect in the 1970s.

This variation largely reflects service levels provided by local governments in the 1970s. Local governments providing many services generally collected more property taxes in the 1970s to

Figure 11

Property Tax Receipts From the 1 Percent Rate for Selected Local Governments

2009-10

Cities	Property Taxes per Resident	Counties	Property Taxes per Resident	Schools[a]	Property Taxes per Student
Industry	$2,541	San Francisco[b]	$1,411	Mono	$10,683
Malibu	559	Sierra	1,126	San Mateo	5,432
Mountain View	344	Inyo	876	Marin	5,213
Los Angeles	332	Napa	522	San Francisco	4,020
Long Beach	268	El Dorado	464	Orange	3,315
Oakland	250	Los Angeles	359	San Diego	2,760
State Average	**242**	**State Average**	**320**	**State Average**	**1,960**
San Jose	200	Alameda	301	Yolo	1,765
Fresno	183	Sacramento	286	Sacramento	1,344
Anaheim	167	Contra Costa	271	San Joaquin	1,163
Santa Clarita	140	San Diego	261	Los Angeles	1,142
Chico	129	Riverside	200	Fresno	810
Modesto	119	Orange	174	Kings	379

[a] Countywide average for K-12 schools.
[b] San Francisco is a city and a county.

pay for those services. As a result, those local governments received a larger share of property taxes under AB 8. For example, cities and counties that provided many government services, including fire protection, park and recreation programs, and water services, typically receive more property tax revenue than governments that relied on special districts to provide some or all of these services.

ARE THERE CONCERNS ABOUT HOW PROPERTY TAXES ARE DISTRIBUTED?

While no system for sharing revenues among governmental entities is perfect, the state's system for allocating property tax revenue from the 1 percent rate raises significant concerns about local control, responsiveness to modern needs, and transparency and accountability to taxpayers. We discuss these concerns separately below and then address the question: Could the state change the allocation system?

Lack of Local Control

Unlike local communities in other states, California residents and local officials have virtually no control over the distribution of property tax revenue to local governments. Instead, all major decisions regarding property tax allocation are controlled by the state. Accordingly, if residents desire an enhanced level of a particular service, there is no local forum or mechanism to allow property taxes to be reallocated among local governments to finance this improvement. For example, Orange County currently receives a very low share of property taxes collected within its borders—about 11 percent. If Orange County residents and businesses wished to expand county services, they have no way to redirect the property taxes currently allocated to other local governments. Their only option would be to request the Legislature to enact a new law—approved by two-thirds of the members of both houses—requiring the change in the property tax distribution. In other words, local officials have no power to raise or lower their property tax share on an annual basis to reflect the changing needs of their communities. As a result, if residents wish to increase overall county services, they would need to finance this improvement by raising funds through a different mechanism such as an assessment or special tax.

Limited Transparency and Accountability

The state's current allocation system also makes it difficult for taxpayers to see which entities receive their tax dollars. Property tax bills note only that a bulk of the payment goes to the 1 percent general levy. Even if taxpayers do further research and locate the AB 8 local government sharing factors for their TRA, it is difficult to follow the actual allocation of revenue because the fund shifts related to ERAF and redevelopment complicate this system.

In addition to making it difficult for taxpayers to determine how their tax dollars are distributed, the AB 8 system reduces government accountability. The link between the level of government controlling the allocation of the tax (the state) and the government that spends the tax revenue (cities, counties, special districts, and K-14 districts) is severed. For example, if a taxpayer believes the level of services provided by an independent park district is inadequate, it is difficult to hold the district entirely accountable

because the state is responsible for determining the share of property taxes allocated to the district.

Limited Responsiveness to Modern Needs and Preferences

An effective tax allocation system ensures that local tax revenue is allocated in a way that reflects modern needs and preferences. In many ways, California's property tax allocation system—which remains largely based on allocation preferences from the 1970s—does not meet this criterion. California's population and the governance structure of many local communities have changed significantly since the AB 8 system was enacted. For example, certain areas with relatively sparse populations in the 1970s have experienced substantial growth and many local government responsibilities have changed. One water district in San Mateo County—Los Trancos Water District—illustrates the extent to which the state's property tax allocation system continues to reflect service levels from the 1970s. Specifically, this water district sold its entire water distribution system to a private company in 2005, but continues to receive property tax revenue for a service it no longer provides.

Changing the Allocation System Is Difficult

Over the years, the Legislature, local governments, the business community, and the public have recognized the limitations inherent in the state's property tax allocation system. Despite the large degree of consensus on the problems, major proposals to reform the allocation system have not been enacted due to their complexity and the difficult trade-offs involved. Because California has thousands of local governments—many with overlapping jurisdictions—reorienting the property tax allocation system would be extraordinarily complex. Updating the AB 8 property tax sharing methodology would require the Legislature to determine the needs and preferences of each California community and local government. This would be a difficult—if not impossible—task to undertake in a centralized manner. Alternatively, the state could allow the distribution of the property tax to be carried out locally, but there is no consensus about what process local governments would use to allocate property taxes among themselves. Whether done centrally or locally, any reallocation is difficult because providing additional property tax receipts to one local government would require redirecting it from another local government or amending the Constitution. In addition, any significant change to the allocation of property tax revenue would require approval by two-thirds of the Legislature due to provisions in the Constitution added by Proposition 1A (2004). (These issues are discussed further in the appendix.)

WHAT ARE THE STRENGTHS AND LIMITATIONS OF CALIFORNIA'S PROPERTY TAX SYSTEM?

For many years, California's overall property tax system—the types of taxes paid by property owners and the determination of property owner tax liabilities—has evoked controversy. Some people question whether the distribution of the tax burden between residential and commercial properties is appropriate and whether the amount of taxes someone pays should depend, in part, on how long he or she has owned the property. Other people praise the financial certainty that the tax system gives property owners. From one year to the next, property owners know that their tax liabilities under the 1 percent rate will increase only modestly. In this section, we do not attempt to resolve this long-standing debate. Instead, we review property taxes by looking at how they measure according to five common tax policy criteria—growth, stability, simplicity, neutrality, and equity. Using this framework, we highlight particular aspects of the state's property tax system, both its strengths and limitations, for policymakers and other interested parties.

Economists use the five common tax policy criteria summarized in Figure 12 to objectively compare particular taxes. These criteria relate to how taxes affect people's decisions, how they treat different taxpayers, and how the revenue raised from taxes performs over time. In practice, all taxes involve trade-offs. Sometimes the trade-offs are between two tax policy criteria. For example, revenue sources that grow quickly may be less stable from one year to the next than other revenue sources. Other times, the trade-offs are between tax policy criteria and other governmental policy objectives that may not be directly related to one of the five tax criteria. For example, one such trade-off might be that ensuring that a property owner's taxes do not increase dramatically from one year to the next (a reasonable governmental policy objective) can result in a tax system in which the owners of similar properties are taxed much differently (contrary to the equity criteria of tax policy).

Figure 12

Common Economic Criteria for Evaluating Tax Systems

- ✓ **Growth—**Does revenue raised by the tax grow along with the economy or the program responsibilities it is expected to fund?
- ✓ **Stability—**Is the revenue raised by the tax relatively stable over time?
- ✓ **Simplicity—**Is the tax simple and inexpensive for taxpayers to pay and for government to collect?
- ✓ **Neutrality—**Does the tax have little or no impact on people's decisions about how much to buy, sell, and invest?
- ✓ **Equity—**Do taxpayers with similar incomes pay similar amounts and do tax liabilities rise with income?

Revenue Growth

From government's perspective, revenue sources that grow along with the economy are preferable because they can provide resources sufficient to maintain current services. This can help governments avoid increasing existing taxes or taxing additional activities in order to meet current service demands.

The Property Tax Has Grown Faster Than the Economy. Personal income in California—an

What Factors Affect Property Tax Growth Each Year?

Most of the annual change in property tax revenues is the result of large changes in assessed value that affect a small number of properties, including:

- ***Recently Sold Properties.*** When a property sells, its assessed value resets to the purchase price. This represents additional value that is added to the tax base because the sale price of the property is often much higher than its previous assessed value.

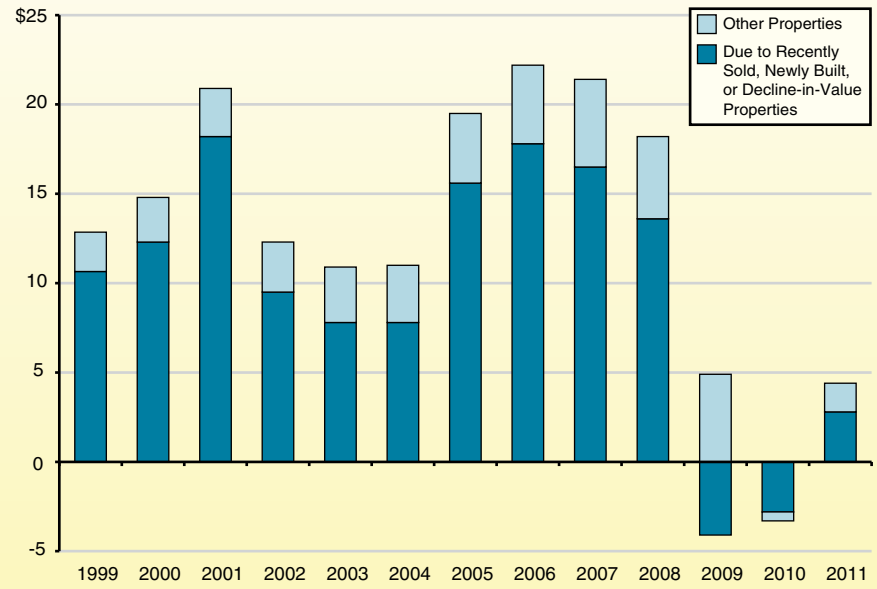
- ***Newly Built Property and Property Improvements.*** New value is added to the county's tax base when new construction takes place or improvements are made—mainly additions, remodels, and facility expansions—because structures are assessed at market value the year that they are built.

- ***Proposition 8 (1978) Decline-in-Value Properties.*** These properties contribute significantly to growth or decline in a county's tax base because their assessed values may increase or decrease dramatically in any year. A particularly large impact on assessed valuation tends to occur in years when a large number of these properties transfer from Proposition 13 assessment to reduced assessment.

As shown by the dark bars in the figure below, recently sold, newly built, and decline-in-value properties typically account for more than two-thirds of total changes in countywide assessed value in Santa Clara County. Other properties, although they represent most of the properties in the county's tax base, contribute less because the growth of these properties' assessed values is limited to 2 percent per year.

Components of Annual Change in County Assessed Valuation in Santa Clara County

(In Billions)

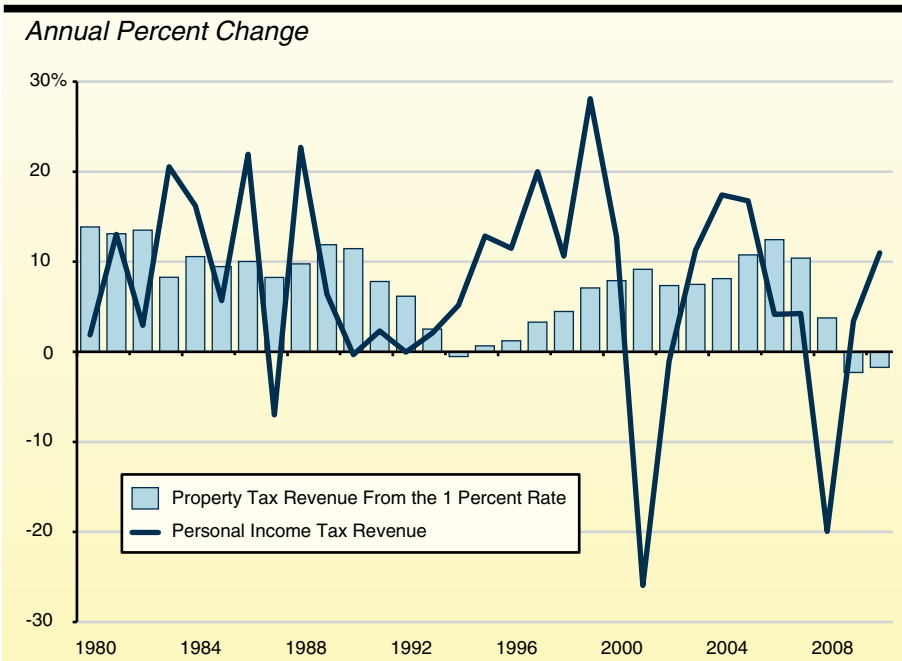


approximate measure of the size of the state's economy—has grown at an average annual rate of 6.3 percent since 1979. Over the same period, revenue from the 1 percent property tax rate has grown at an average annual rate of 7.3 percent. As we describe in the nearby box, much of the growth in property tax revenue depends on new construction and property sales.

The Growth of Parcel and Mello-Roos Tax Revenues Depends on the Structure of the Tax. The terms of parcel taxes and Mello-Roos taxes vary by locality. Some local governments have taxes with escalation clauses or other provisions that modify the amount of the tax as local government costs change. Other parcel taxes and Mello-Roos taxes are set at fixed amounts per parcel. Depending on their structure, these taxes may or may not provide local governments with a growing source of revenue.

Figure 13

Property Tax Revenue Is Much Less Volatile Than Personal Income Tax Revenue



Revenue Stability

Revenue sources that remain relatively stable from one year to the next help governments manage economic downturns, which tend to reduce revenue and at the same time increase demand for certain public services. Stable revenue sources also may help governments plan more effectively for future needs, including long-term investments in transportation, education, and public safety.

The Property Tax Is a Stable Revenue Source. Despite being linked to the volatile real estate market, the property tax is California's most stable major revenue source. Since 1979, as shown in Figure 13, personal income tax revenue has been three times more volatile, on average, than property tax revenue from the 1 percent rate. During the same period, statewide property tax revenue has declined in only three years, 1994-95, 2009-10, and 2010-11.

The Property Tax Was More Stable Than Other Revenue Sources During the Recent Recession. As shown in Figure 14, revenue from the 1 percent property tax rate fared comparatively well during the most recent recession. (In the nearby box, we discuss why the property tax is stable.) Changes in property tax revenue tend to lag economic trends by one or more years because of the state's acquisition value assessment system and the lengthy period between when most properties are assessed (January) and when property tax payments are due (December of that year and April of the next).

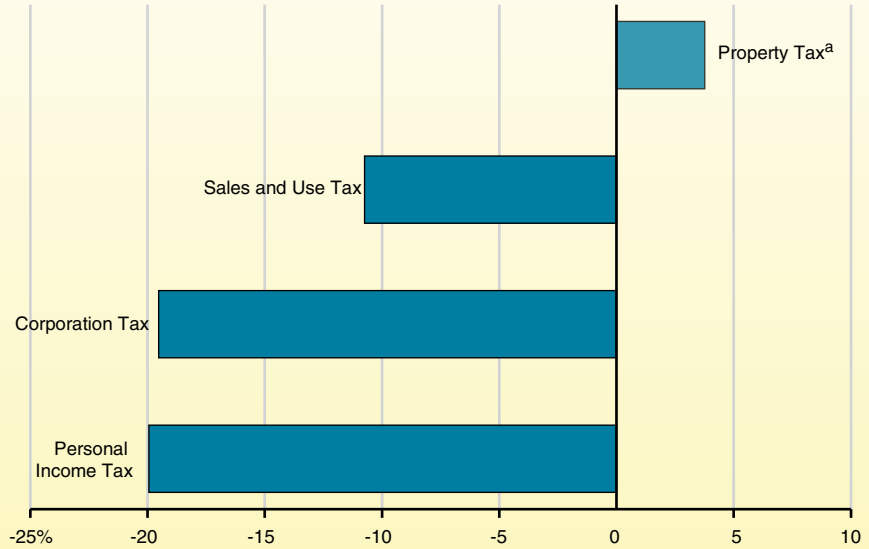
Parcel Taxes and Mello-Roos Taxes Also Are Stable. Because most parcel and Mello-Roos taxes are set at fixed amounts per parcel, there is minimal year-to-year fluctuation in the revenues that they raise.

Assessed Valuation in Some Counties, However, Has Declined Significantly. Though statewide property tax revenue has remained comparatively stable throughout the recent recession, some areas of the state have experienced considerable declines

Figure 14

Property Tax Revenue During the Recent Recession

Percent Change 2007-08 to 2008-09



[a] Revenue from the 1 percent rate.

What Factors Affect Property Tax Stability?

Acquisition Value Assessment System Contributes to Revenue Stability. The main reason California's property tax revenue is stable is that the assessed value of most properties increases each year by a maximum of 2 percent. In any given year, only a small fraction of properties are sold and reset to market value. This means that real estate conditions affect a relatively small portion of the tax base each year, insulating property tax revenue from year-to-year real estate fluctuations.

Proposition 8 (1978) Decline-in-Value Properties Reduce Revenue Stability. As noted earlier in the report, county assessors may reduce a property's assessed value in the event that its market value falls below its assessed value. Each year thereafter, the property is assessed at market value until it rises above what its assessed value would have been had it remained at its acquisition value adjusted upward each year at a maximum of 2 percent. During 2010-11, more than one in four properties in California was temporarily assessed to market value. Because these properties are assessed each year at market value, they link the property tax base more closely to the local real estate market than other properties, thereby reducing the property tax's stability somewhat.

in their property tax base. These counties tend to have a large proportion of their properties under Proposition 8 decline-in-value assessments and have high foreclosure rates. For example, Riverside County had the second highest number of foreclosures (17,000) among counties and more than 400,000 decline-in-value properties in 2011. Partly as a result of these trends, total assessed value in Riverside County declined by 15 percent between 2008 and 2011.

Simplicity

A well-designed tax system should be simple for taxpayers to understand and easy and inexpensive for governments to administer. Complex tax systems can be expensive for governments to administer effectively and may be confusing, time-consuming, and costly for taxpayers.

Most of the costs associated with administering the state's property tax system (ad valorem property taxes, parcel taxes, and Mello-Roos taxes) reflect the activities by county assessors, tax collectors, and auditors. While comprehensive data on these costs are not available, total property tax administration costs likely are between 1.5 percent and 2 percent of collections, a somewhat higher level than that of state tax agencies that perform similar functions. A significant component of the property tax's administrative cost is from counties' responsibility to allocate property taxes to local governments pursuant to increasingly complex state laws. County costs related solely to determining property values, the other main component of administration, were slightly less than 1 percent of total revenues collected in 2010-11—a percentage similar to that of state tax agencies.

From the taxpayers' perspective, the property tax is generally a simple tax with which to comply. Tax payments are due in equal installments twice per year. And, in most years, the assessed value of real property grows automatically by a maximum of 2 percent. Reassessments based on market value (which taxpayers are more likely to appeal) occur infrequently for most property owners.

The property tax assessed on personal property is typically more administratively cumbersome for owners and assessors. This is because personal property is assessed annually at market value using complex depreciation schedules. These assessments, therefore, are more likely to be appealed, a process that can take more than a year to resolve.

Neutrality

Nearly all taxes alter taxpayer behavior to some degree. Economists agree, however, that in most cases the ideal tax system is one that alters decisions—about what goods to buy, what products to make, and where to work or live—as little as possible. Economists prefer these "economically neutral" taxes because they assume that people and businesses are in the best position to make consumption, savings, and investment decisions that meet their economic and personal needs. Tax policies that influence what people buy and what businesses produce tend to distance people and businesses from their preferred choices, leaving them less well off than they would be if the tax system were economically neutral. Policymakers design some taxes, on the other hand, to influence taxpayer behavior in a way that promotes or discourages particular activities. In general, these should be well targeted and have strong justifications so that they achieve their policy goals with as little interference as possible in other personal decision making. Below, we describe how ad valorem property taxes may influence taxpayer behavior and then discuss the possible effects of parcel and Mello-Roos taxes.

Some Homeowners and Businesses May Move Less Frequently. California's ad valorem

property taxes may affect an individual's decision to move because longer ownership results in a lower effective property tax rate. (An effective property tax rate differs from the 1 percent basic rate in that it is the amount of property taxes paid divided by the current market value of the property.) As shown in Figure 15, effective tax rates can vary considerably. New Owner A, for example, has an effective tax rate of 1 percent because the assessed value of his or her property is the same as its market value. Owners B and C, who have owned their properties longer than Owner A, have assessed values below their market values because their market values increased by more than 2 percent each year (and therefore faster than assessed values). As a result, most owners who have owned a property for many years pay an effective tax rate well below 1 percent. For those choosing to move, however, their effective tax rate is reset to 1 percent, producing a moving penalty that may influence some property owners' relocation decisions. For example, established firms that benefit from their comparatively low effective property tax rates could be dissuaded from relocating—decisions that, absent the moving penalty, could benefit the companies financially. (As we discuss below, differing effective tax rates also affect the equity of the property tax.)

Homeowners and Businesses May Invest Less in Property Improvements. When a property undergoes improvements, the newly constructed portion of the property is assessed at its full market value. The existing property, on the other hand, is typically assessed below its current market value, meaning that improvements are taxed at a higher effective rate than existing property. Because improvements are subject to higher effective tax rates, the return on investment that businesses receive from new improvements is lower and the taxes that homeowners pay on them are higher than they would be if all property—new and existing—were taxed uniformly. This may lead some businesses and homeowners to invest less than they otherwise would in new property improvements.

Homeowners May Change Behavior in Response to Assessment Exclusions. Voters have approved ballot propositions that exclude some types of property transfers from triggering reassessment to market value. (These exclusions are summarized earlier in this report in Figure 2.) For example, residential property transfers between certain family members do not trigger reassessment. These exclusions could alter decisions homeowners make about their property. For example, a homeowner might transfer property to his or her child (thereby passing on his or her low effective property tax rate) when, absent the exclusion, the owner might have sold the property to a nonrelative. In turn, that child could find it more economical to rent the property (and benefit from the low effective property tax rate) than to sell (and forego the benefit of his or her low effective rate).

Equity

Equity relates to how taxes affect taxpayers with different levels of income or wealth. Economists use two different standards of equity—vertical and horizontal—to evaluate taxes. Vertical equity occurs when wealthier taxpayers

Figure 15

Hypothetical Effective Property Tax Rates for Three Property Owners

	Year Purchased	Market Value	Assessed Value	Property Tax Rate	Property Tax Paid	Effective Tax Rate
Owner A	2012	$300,000	$300,000	1%	$3,000	1.0%
Owner B	2002	300,000	180,000	1	1,800	0.6
Owner C	1986	300,000	110,000	1	1,100	0.4

pay a greater amount in taxes than less wealthy taxpayers. Horizontal equity, on the other hand, occurs when similar taxpayers—those with similar incomes or wealth—pay the same amount in taxes. Under an equitable property tax system (1) owners of highly valuable property pay more in taxes than owners of less valuable property and (2) the owners of two similar properties pay a similar amount in property taxes. Put differently, an equitable system would tax property owners at the same effective rate. As we discussed in the previous section, however, property owners often are subject to different effective tax rates. Therefore, California's ad valorem property taxes, parcel taxes, and Mello-Roos taxes often do not meet these standards of equity.

Equity Reduced by Acquisition Value Assessment and 2 Percent Assessed Value Cap. California's property tax system does not consistently meet the standards of horizontal or vertical equity. As discussed earlier in this report, two owners with identical properties may pay different amounts of property taxes if one owner bought the property a decade before the other. In a tax system with horizontal equity, both owners would pay similar amounts. In relation to vertical equity, the tax system's reliance on acquisition value and the 2 percent cap on assessed valuation growth can result in owners of valuable property paying less than owners of (recently acquired) less valuable property. In a tax system with vertical equity, owners of valuable property would pay more in taxes because owners of valuable property generally are wealthier than owners of less valuable property.

Homeowners Who Are Mobile Pay Higher Effective Tax Rates. Homeowners who move often—military families, younger homeowners, or those with jobs that require them to relocate frequently—tend to have higher effective ad valorem tax rates than homeowners who move less frequently because newly purchased properties are assessed at market value. Relocation decisions may result from circumstances that households may not have foreseen, such as employment changes, divorce, or other changes in family composition. Under horizontal equity, in contrast, taxpayers pay similar taxes unless their household income, wealth, or consumption patterns differ.

Fixed-Rate Taxes Do Not Meet Vertical Equity Standard. Parcel taxes and Mello-Roos taxes typically meet the criteria of horizontal equity but not vertical equity because property owners typically are charged the same amounts—regardless of their wealth or their properties' value.

Summary

Our comparison of California's property tax system with common tax policy criteria found mixed results. The ad valorem taxes generally meet the goals of administrative simplicity and providing governments with a growing source of stable revenue, but often do not meet the goals of neutrality and equity. Specifically, California's ad valorem tax system (1) may influence decisions property owners make about relocations and expansions and (2) treat similar taxpayers differently and wealthier taxpayers the same as less wealthy taxpayers.

California's other property taxes (parcel taxes and Mello-Roos taxes) generally perform well relative to the goals of stability, administrative simplicity, and horizontal equity, but may perform less well in regard to the other objectives.

APPENDIX 1:

THE HISTORY OF CALIFORNIA'S PROPERTY TAX ALLOCATION SYSTEM

California's system for allocating property tax revenue from the 1 percent rate among local governments is complex and has changed over time. The most significant change was voter approval of Proposition 13 in 1978, which shifted the control over the allocation of property taxes from local communities to the state. Since that time the state has made several major changes that affect the amount of property tax revenue from the 1 percent rate distributed to counties, cities, K-14 districts, and special districts. Some of these changes have benefited the state fiscally (by indirectly reducing state costs for education). Others have benefited local governments or taxpayers. This appendix describes the evolution of the state's property tax allocation system. The key events are highlighted in Figure A-1, and described in more detail below.

Figure A-1

History of California's Property Tax Allocation

1972	**SB 90—**Establishes school "revenue limit" funding system, giving the state a significant fiscal interest in the allocation of local property tax revenue.
1978	**Proposition 13—**Voters cap the basic property tax rate at 1 percent and give the state new responsibilities for allocating property tax revenue.
	SB 154—State's first law allocating property tax revenue. Amounts based on share of property tax received prior to Proposition 13, with state providing grants for some of local revenue loss.
1979	**AB 8—**State changes property tax allocations in SB 154, establishes system for allocating future growth in property tax revenue, and absorbs costs of some local programs.
1992	**First ERAF Shift—**State permanently shifts some property tax revenue from counties, cities, and special districts into a fund for K-14 districts.
1993	**Second ERAF Shift—**State permanently shifts additional property tax revenue into a fund for K-14 districts.
2004	**Triple Flip—**State uses some local sales tax revenue to repay deficit-financing bonds. Reimburses counties and cities with property tax revenue from ERAF and K-14 districts.
	The VLF Swap—State permanently shifts some property tax revenue from ERAF and K-14 districts to reimburse cities and counties for the state's reductions to their VLF revenue.
	Temporary ERAF Shift—State shifts some property tax revenue from noneducational local agencies to K-14 districts for two years.
	Proposition 1A—Voters restrict the state's authority to shift property tax revenue away from cities, counties, and special districts.
2009	**Proposition 1A (2004) Borrowing—**State borrows $1.9 billion of property tax revenue from cities, counties, and special districts as authorized by Proposition 1A.
2010	**Proposition 22—**Voters eliminate the state's authority to borrow property tax revenue and to shift redevelopment agencies' property tax revenue.
2012	**Dissolution of Redevelopment Agencies—**Redevelopment agencies are abolished. Over time, their share of the property tax will revert to other local governments.

ERAF = Educational Revenue Augmentation Fund; VLF = vehicle license fee.

TAX ALLOCATION PRIOR TO PROPOSITION 13

Tax Allocation Determined Locally Until 1978. Prior to voter approval of Proposition 13 in 1978, each local government authorized to levy a property tax set its own rate (within certain statutory restrictions). Each local government annually determined the amount of revenue necessary to finance the desired level of services and set its property tax rate to collect that amount. A property owner's property tax bill reflected the sum of the individual rates set by each taxing entity. Under this system, schools and community colleges received over 50 percent of statewide property tax revenue, counties about 30 percent, and cities about 10 percent. (At the local level, however, the share of property tax revenue supporting each type of local government varied. Some communities, for example, provided a greater percentage of total property tax revenue to schools and others provided more to their county or city.)

Property Tax Allocation Linked to State Budget in 1972. Although local governments had control over the property tax during this period, property tax revenue had an effect on the state's budget beginning in 1972. Chapter 1406, Statutes of 1972 (SB 90, Dills), started an education finance system in which the state guarantees each school district an overall level of funding. For K-12 districts, each district receives an overall level of funding—a "revenue limit"—from local property taxes and state resources combined. Community college districts receive apportionment funding from local property taxes, student fees, and state resources. Thus, if a district's local property tax revenue (and student fee revenue in the case of community colleges) is not sufficient, the state provides additional funds. If a district's nonstate resources alone exceed the district's revenue limit or apportionment funding level, the district does not receive state aid and can keep the excess local property tax revenue for educational programs and services at their discretion. These districts are commonly referred to as "basic aid" districts because historically they have received only the minimum amount of state aid required by the California Constitution (known as basic aid). This system of school finance gives the state a significant fiscal interest in the distribution of local property tax revenue.

PROPOSITION 13 AND THE STATE'S RESPONSE

Proposition 13 fundamentally changed local government finance and assigned the state responsibility for property tax allocation. Property tax receipts fell by more than 60 percent because Proposition 13 lowered the statewide property tax rate to a constitutional maximum of 1 percent. Additionally, the measure required the state, rather than local communities, to determine the allocation of property tax revenue among the local governments within a county. In response to Proposition 13, the Legislature enacted two major bills: Chapter 292, Statutes of 1978 (SB 154, Petris) and then Chapter 282, Statutes of 1979 (AB 8, L. Greene). In general, these bills established methods for allocating the new lower amount of property tax revenue and shifted certain county and school district costs to the state.

First State Allocation System—SB 154

Shortly after the passage of Proposition 13, the Legislature approved SB 154 in an effort to avoid major local government service reductions

and significant fiscal distress from the decrease in property tax revenue. Senate Bill 154 was the state's first attempt to allocate property taxes among counties, cities, special districts, and K-14 districts. Under SB 154, a local government's share of the 1 percent property tax rate in 1978-79 was based on the share of *countywide* property tax revenue going to that local government before Proposition 13. For example, if a city received 10 percent of the property taxes collected by all local jurisdictions in the county prior to the passage of Proposition 13, the city would receive 10 percent of the property taxes collected in the county at the 1 percent rate. This was a significant change from the allocation of property taxes prior to Proposition 13, when a local government received property tax revenue only from the properties located *within its jurisdiction*. In addition, to partially offset the revenue loss resulting from the reduction in the property tax rate, SB 154 used state funds to relieve counties of a portion of their obligation to pay for certain health and welfare programs and to provide block grants to counties, cities, and special districts.

The Current Property Tax Allocation System—AB 8

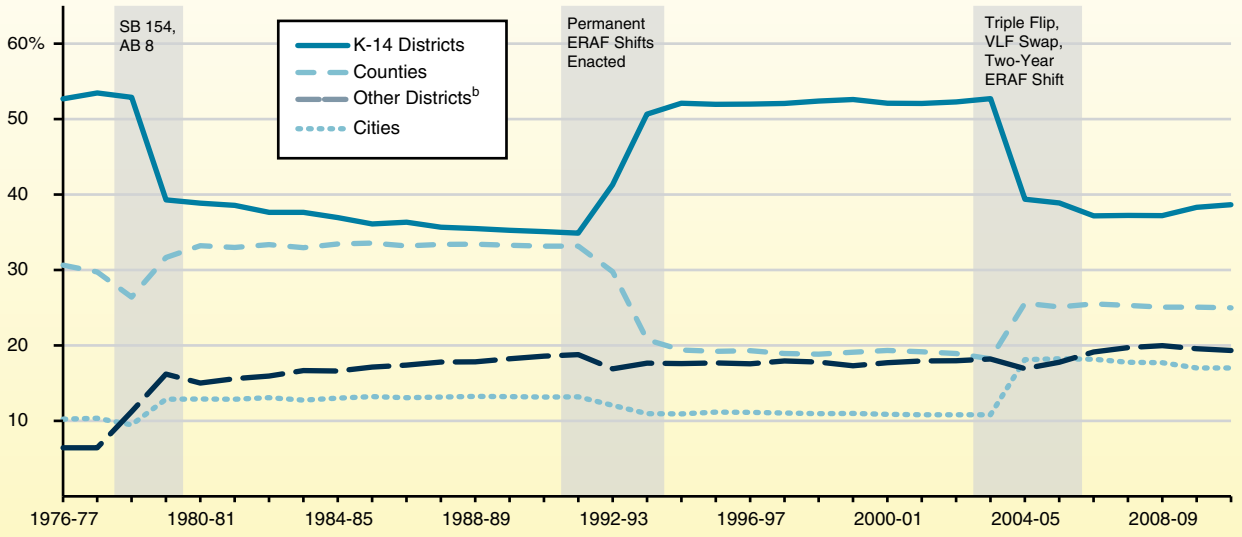
A year after enacting SB 154, the Legislature adopted AB 8, a long-term policy to allocate property taxes and provide fiscal relief to local governments. The legislation (1) directed county auditors to allocate 1979-80 property tax revenue in a manner similar to SB 154 but with some modifications and (2) established a method for allocating property tax growth in future years.

New Base Property Tax Allocation. Assembly Bill 8 established a new base property tax allocation for 1979-80. The new base allocations in AB 8 resembled those in SB 154—a local government's share was based on the share of the countywide property tax going to that local government before Proposition 13—with some modification. Specifically, rather than continue the state block grants included in SB 154, AB 8 increased the base share of property taxes allocated to most counties, cities, and special districts by reducing the base share going to K-14 districts. (Under the state's school finance system, K-14 district losses were in turn made up with increased state funds for education.) For cities and special districts, the increase in the base property tax allocation was derived from the block grant amount provided in SB 154. Cities received increased property taxes equivalent to about 83 percent of their SB 154 block grant amount and special districts 95 percent of their block grant amount. Counties received a combination of increased property taxes, reduced expenditure obligations for health and social services programs, and a state block grant for indigent health programs. The reduced county expenditure obligations included complete state assumption of the costs for Medi-Cal and the State Supplementary Payment Program, as well as an increased state share of costs for the Aid to Families with Dependent Children program (the predecessor to California Work Opportunities and Responsibility to Kids). (These changes resulted in an increased share of property tax revenue for most counties. As discussed in the box on page 36, six counties ended up as so-called negative bailout counties.) In summary, AB 8 shifted property tax revenue away from K-14 districts in order to provide cities, special districts, and most counties with a greater amount of property tax revenue than they received the previous year under SB 154. As shown in Figure A-2 (see next page), this greatly reduced K-14 districts' share of the statewide property tax.

New Method for Allocating Property Tax Growth. Assembly Bill 8 also established a new process for allocating growth (or decline) in property tax revenue in future years. In contrast to the property tax allocation process in 1978-79 and

Figure A-2

Major Changes in Allocation of California Property Tax Revenue[a]



[a] As a percentage of total revenue from the 1 percent rate and voter-approved debt rates.
[b] Special districts and redevelopment agencies. Payments from redevelopment agencies to K-14 schools not included.
ERAF = Educational Revenue Augmentation Fund; VLF = vehicle license fee.

1979-80 (that distributed revenue on a countywide basis without regard to where the property was located), the legislation specified that future growth in property tax revenue would be allocated only to those local governments serving the property where the revenue increase took place. Accordingly, beginning in 1980-81, AB 8 required that each local government receives the same amount of property tax it received in the prior year plus its share of any growth or decline in property tax revenue that occurred in its jurisdiction.

To ensure that each local government receives the property tax growth from the properties it serves, each county is divided into tax rate areas (TRAs). Each local government represented in a TRA receives a share of the property tax growth

What Are "Negative Bailout Counties?"

Assembly Bill 8 did not provide additional property tax revenue to six counties (Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity). Under the provisions of AB 8, the increased share of the base property tax allocation to counties was calculated as the value of the SB 154 block grant *plus* a small adjustment for the cost of the Aid to Families with Dependent Children program *less* the amount of the indigent health block grant. In these six counties, the value of the indigent health block grant was so great that it exceeded the value of the adjusted SB 154 block grant. In order for these counties to be treated in the same way as all other counties, the amount of property taxes allocated to these counties was reduced. Because these counties received a smaller percentage of total property taxes collected after implementation of AB 8 relative to their pre-Proposition 13 shares, these counties are termed negative bailout counties.

that occurs within that TRA. As required by AB 8, county auditors developed a methodology to determine the percentage of property tax growth—known as TRA factors—to allocate to each local government in each TRA. These TRA factors were based largely on the 1979-80 base allocation established by AB 8 (including the shift of property tax revenue from K-14 districts to other local governments). In most counties, these TRA factors remain constant. Thus, if a city received 25 percent of the property tax revenue growth generated in a TRA in 1980-81 (the first year TRA factors were used to distribute property tax revenue growth), it continued to receive 25 percent of the growth in property taxes in future years. As a result, the distribution of property tax revenue among local governments continued to closely resemble the 1979-80 distribution until the first major changes to the AB 8 system occurred in the 1990s.

In summary, the AB 8 property tax allocation system provides each local government with the same amount of property tax revenue it received in the prior year (the base), plus its share of any growth or decline in property tax revenue that occurred in its jurisdiction in the current year.

CHANGES TO THE AB 8 SYSTEM

The state property tax allocation system set up in AB 8 continues to be the basis for property tax allocation among local governments today. Since 1979, however, there have been some significant changes to the original property tax allocation system contained in AB 8. In most cases, the changes reflect the complex fiscal relationship between the state and local governments. Because of the state's role in allocating property tax revenue after Proposition 13 and in funding K-14 districts and other local programs, decisions regarding the state budget and other policy issues have led the Legislature and Governor to occasionally change how property tax revenue is distributed. We highlight the major changes in property tax allocation below. It is important to note, however, that these changes in property tax allocation do not explain the entire scope of the state-local fiscal relationship—a relationship that also has involved the realignment of many government programs and changes in other revenue sources such as the sales tax and the vehicle license fee (VLF). Some of these decisions have benefited the state fiscally, and others have benefited local governments or taxpayers.

No and Low Property Tax Cities

One change in property tax allocation relates to so-called "no and low property tax cities." Cities that did not levy a property tax, levied only a very low property tax, or were not incorporated as cities prior to the passage of Proposition 13 typically received few property taxes under AB 8. During the 1980s the Legislature directed county auditors to modestly increase the amount of property taxes going to some of these cities by shifting a share of county property tax revenue to them.

Property Taxes Shifted to Schools

Ongoing Property Tax Shifts Started in 1990s. In 1992-93 and 1993-94, in response to serious budgetary shortfalls, the Legislature and Governor permanently redirected almost one-fifth of statewide property tax revenue—over $3 billion in 1993-94—from cities, counties, and special districts to K-14 districts. (The legislation also temporarily required redevelopment agencies to make payments to K-14 districts.) Under the changes in property tax allocation laws, the redirected property tax revenue is deposited into a countywide fund for

schools, the Educational Revenue Augmentation Fund (ERAF). The property tax revenue from ERAF is distributed to non-basic aid schools and community colleges, reducing the state's funding obligation for K-14 school districts.

The amount transferred into ERAF from each city, county, and special district was based on many factors, including the magnitude of the fiscal relief that the state provided the local government in AB 8 and, for counties, the level of taxable sales within its borders. As a result, individual local government ERAF obligations varied widely. For example, the ERAF shifts from cities formed after 1978 typically were lower than those for older cities because the newer cities did not receive any AB 8 benefits. Similarly, counties with many retail developments typically had larger ERAF shifts than rural counties because the state anticipated that extensively developed counties would receive more relief from the state's primary ERAF mitigation measure: a half-cent sales tax for local public safety (Proposition 172, 1993). As shown in Figure A-2, after the ERAF transfer of the early 1990s, schools and community colleges once again received more than 50 percent of the state's property tax revenue, while other local governments received less.

"Excess ERAF" Shifted Back. In the late 1990s, some county auditors reported that their ERAF accounts had more revenue than necessary to offset all state aid to non-basic aid K-14 districts. In response, the Legislature enacted a law requiring that some of these surplus funds be used for countywide special education programs and the remaining funds be returned to cities, counties, and special districts in proportion to the amount of property taxes that they contributed to ERAF. The ERAF funds that are returned to non-education local governments are known as excess ERAF.

Additional Temporary Property Tax Shift. The 2004-05 budget package also shifted $1.3 billion of property taxes from noneducation local agencies (cities, counties, special districts, and redevelopment agencies) to ERAF in 2004-05 and again in 2005-06. This temporary ERAF shift reduced the state's funding responsibilities for K-14 districts to help address the budget shortfalls in those two years.

Changes to ERAF

The Triple Flip. In 2004, state voters approved Proposition 57, a deficit-financing bond to address the state's budget shortfall. The state enacted a three-step approach—commonly referred to as the triple flip—that provides a dedicated funding source to repay the deficit bonds:

- Beginning in 2004-05, one-quarter cent of the local sales tax is used to repay the deficit-financing bond.
- During the time these bonds are outstanding, city and county revenue losses from the diverted local sales tax are replaced on a dollar-for-dollar basis with property taxes shifted from ERAF.
- The K-14 tax losses from the redirection of ERAF to cities and counties, in turn, are offset by increased state aid.

The triple flip increases the amount of property tax revenue going to cities and counties and reduces the amount of ERAF provided to K-14 districts. Overall, however, cities, counties, and K-14 districts do not experience any net change in revenue from the triple flip. Cities and counties receive more property tax revenue, but this revenue gain is offset by the reduction in sales tax revenue. K-14 districts receive less property tax revenue, but this is offset with increased state aid. The flip of sales taxes for property taxes ends after the deficit-financing bonds are repaid (currently estimated to occur in 2016).

The VLF Swap. The VLF—a tax on vehicle ownership—provides revenue to local governments. In 1999, the state began reducing the VLF rate and backfilling city and county revenue losses from this tax reduction with state aid. The 2004-05 budget package permanently replaced the state VLF backfill by diverting property tax revenue from ERAF and, if necessary, non-basic aid K-14 districts to cities and counties. In 2004-05, cities and counties did not experience a change in overall revenue from the VLF swap, as the amount of property tax shifted to them was equal to the VLF backfill amount. In subsequent years, state law specifies that each local government's VLF swap payment grows based on the annual change in its assessed valuation. As a result, most cities and counties benefit fiscally from the VLF swap because assessed valuation typically grows more quickly than VLF revenue. Similar to the triple flip, K-14 districts' property tax revenue losses are made up with increased state aid.

Distributing ERAF

The triple flip and VLF swap further expanded the use of ERAF and changed the priorities governing how its resources are used. As shown in Figure A-3, the original purpose of ERAF was to supplement the property tax revenue of non-basic aid K-14 districts. Under current law, however, funding K-14 districts falls to the fourth priority. As a result, non-basic aid school districts do not receive any ERAF resources unless additional funds remain after the county auditor (1) returns excess ERAF, (2) reimburses the triple flip, and (3) make payments for the VLF swap. This change in priorities has a significant effect on the amount of ERAF available for school districts. In 2010-11, for example, auditors in 33 counties reported using *all* ERAF resources for the first three priorities, leaving no ERAF for schools.

Figure A-4 (see next page) displays the complex process county auditors follow to allocate ERAF and to reimburse cities and counties for the triple flip and VLF swap. This figure also shows that, under certain circumstances, it is possible that the auditor could determine that there are not enough funds to fully compensate cities and the county for the triple flip and/or the VLF swap. These funding insufficiencies are referred to as "insufficient ERAF."

Step 1: Return Excess ERAF. As shown in the figure, the first step is for each county auditor to determine whether the funds deposited into the countywide account exceed the amount needed by all non-basic aid K-14 districts in the county, plus a specified amount for special education. If so, the excess ERAF is returned to cities, special districts, and the county in proportion to the amount of property taxes they contributed to ERAF. This calculation of excess ERAF was modified recently to reflect the increased revenue that K-14 districts and ERAF receive from the dissolution of redevelopment agencies. Specifically, to maximize the state fiscal benefit related to redevelopment

Figure A-3

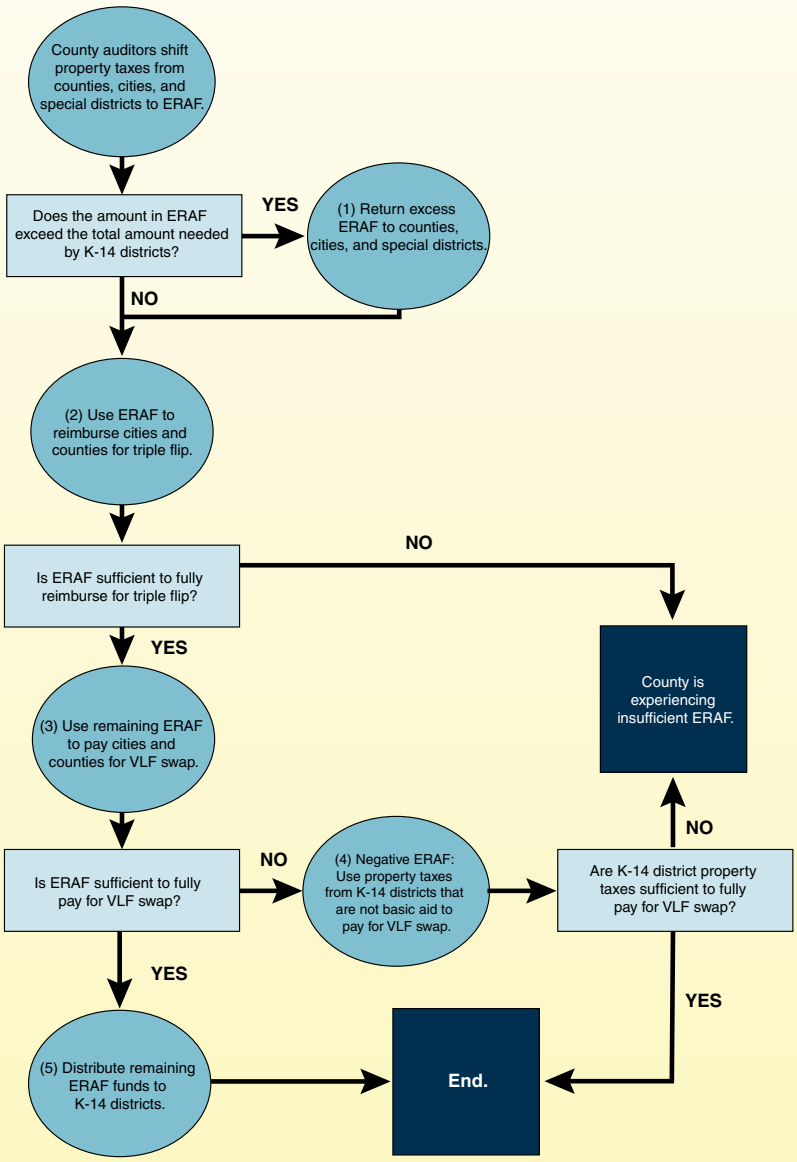
Uses of ERAF Listed in Priority Order

Priority	Early 1990s	Late 1990s to 2004	2004 to Present
First	**Fund non-basic aid K-14 districts**	Return excess ERAF	Return excess ERAF
Second		**Fund non-basic aid K-14 districts**	Reimburse triple flip
Third			Make payments for VLF swap
Fourth			**Fund non-basic aid K-14 districts**

ERAF = Educational Revenue Augmentation Fund; VLF = vehicle license fee.

Figure A-4

Process to Distribute ERAF and Reimburse the Triple Flip and VLF Swap



ERAF = Educational Revenue Augmentation Fund; VLF = vehicle license fee.

dissolution, Chapter 26, Statues of 2012 (AB 1484, Committee on Budget) directs county auditors to exclude property taxes related to the dissolution of redevelopment agencies in the calculation of excess ERAF.

Step 2: Reimburse Triple Flip. Following the calculation and distribution of excess ERAF, state law directs county auditors to reimburse local governments for their revenue losses associated with the triple flip. This reimbursement is shown in the figure as step two. If the county auditor uses all available ERAF, but determines that the local governments have not been fully reimbursed for the triple flip, the county has insufficient ERAF. In this situation, additional state action is required if cities and counties are to be fully reimbursed for the triple flip.

Steps 3 and 4: Pay for VLF Swap. After reimbursing the triple flip, the next use of ERAF is to make payments to local governments for the VLF swap. If the county auditor determines that ERAF resources are not sufficient to fully pay cities and the county for the VLF swap, the county auditor redirects some property taxes from non-basic aid K-14 districts for this purpose, as shown in step 4. The redirection of school property taxes is commonly referred to as negative ERAF because it decreases K-14 property taxes rather than supplementing them (the original purpose of ERAF). If the amount of property taxes deposited in ERAF and allocated to non-basic aid school district is not enough to make the payments required under the VLF swap, then the county has insufficient ERAF. In this situation, additional state action is required for cities and counties to receive the full VLF swap payment. In 2012-13, the first time this issue came before the Legislature, the state included $1.5 million in the budget to compensate the county and cities in Amador County for insufficient ERAF.

Step 5: Distribute Remaining ERAF to K-14 Districts. Any funds remaining in ERAF after the other uses have been satisfied are distributed to schools and offset state education spending.

LIMITS ON THE STATE'S AUTHORITY OVER PROPERTY TAX ALLOCATION

The state's use of property tax shifts to help resolve its severe budget difficulties—as well as other actions affecting the state-local fiscal relationship—have been a source of considerable friction between state and local government. In response, local government advocates have sponsored initiatives to limit the state's authority over local finances, including two constitutional measures reducing the state's authority over property tax allocation. As a result, much of the authority granted to the state in Proposition 13 and used to establish AB 8, ERAF, the VLF swap, and the triple flip is now restricted.

Proposition 1A (2004)

In 2004, voters approved Proposition 1A, amending the State Constitution to prohibit the state from shifting property tax revenue from cities, counties, and special districts to K-14 districts. The measure, however, provided an exception to its restrictions. Beginning in 2008-09, the measure allowed the state to shift a limited amount of local property tax revenue to schools and community colleges provided that the state repaid local governments for their property tax losses, with interest, within three years. The measure also specified that any change in how property tax

revenue is shared among cities, counties, and special districts must be approved by two-thirds of both houses of the Legislature (instead of by majority vote). For example, state actions that shift a share of property tax revenue from one local special district to another, or from the county to a city, require approval by two-thirds of both houses of the Legislature.

The state utilized Proposition 1A's exception for shifting property tax revenue to provide state fiscal relief in its 2009-10 budget package. Specifically, the state borrowed $1.9 billion of property tax revenue from cities, counties, and special districts—revenue equal to roughly 8 percent of each local agency's property tax revenue. (Under Proposition 1A, the state was required to repay these funds by 2012-13. Companion legislation, however, allowed local governments to borrow against the state's future repayments so that local government budgets were not negatively affected in 2009-10.) The 2009-10 budget package also required redevelopment agencies to make payments totaling $1.7 billion (2009-10) and $350 million (2010-11) to K-12 school districts serving students living in or near their redevelopment areas. Unlike the borrowing from cities, counties, and special districts, the state did not reimburse redevelopment agencies for these required payments.

Proposition 22 (2010)

In 2010, voters approved Proposition 22, which, among other things, prohibits the state from redirecting property tax revenue as it did in 2009-10. Specifically, Proposition 22 eliminates the state's authority to borrow property tax revenue from local governments as previously allowed under Proposition 1A and prohibits the state from requiring redevelopment agencies to shift revenue to K-14 districts or other agencies. As discussed in the nearby box, the prohibition on shifting redevelopment funds contributed indirectly to the dissolution of redevelopment agencies in February 2012.

The Dissolution of Redevelopment Agencies

As discussed in our report, *The 2012-13 Budget: Unwinding Redevelopment*, redevelopment had the overall effect of increasing state costs for K-14 education. For this reason, the state frequently required redevelopment agencies to shift some funds to support K-14 education. Under Proposition 22 (2010), however, the state no longer had the authority to require redevelopment agencies to shift property tax revenue to school districts. Facing considerable fiscal constraints and not authorized to shift funds from redevelopment for state fiscal relief as it had done in the past, the Legislature took a new approach as part of the state's 2011-12 budget. Specifically, the Legislature approved and the Governor signed Chapter 5, Statutes of 2011 (ABX1 26, Blumenfield), which dissolved all redevelopment agencies. They also approved Chapter 6, Statutes of 2011 (ABX1 27, Blumenfield), allowing redevelopment agencies to avoid dissolution by voluntarily agreeing to make annual payments to school districts. The Supreme Court later ruled ABX1 27 unconstitutional, meaning all redevelopment agencies were subject to ABX1 26's dissolution requirement. Under the dissolution process, the property tax revenue that formerly went to redevelopment agencies is first used to pay off redevelopment debts and obligations and the remainder is distributed to local governments in accordance with AB 8.

LOOKING FORWARD

Proposition 1A and Proposition 22 limit the state's authority to change property tax allocation laws. Measures that reallocate property tax revenue among counties, cities, and special districts require a two-thirds vote of the Legislature and measures that change state laws to increase the percentage of property taxes allocated to schools are prohibited. Even without additional legislative action, however, the distribution of property tax revenue will change in the near future for two reasons.

- ***End of Redevelopment.*** As the debts and obligations of former redevelopment agencies are paid off, property tax revenue that previously was allocated to redevelopment agencies will be distributed to K-14 districts, counties, cities, and special districts.
- ***The End of the Triple Flip.*** We estimate that the state's deficit-financing bonds will be paid off in 2016-17. At that time, the state sales tax rate will decline by one-quarter cent and the local sales tax rate will increase by one-quarter cent. Because the local sales tax rate is restored in full, the property tax revenue currently used to backfill cities and counties for the loss in sales tax revenue will be allocated to K-14 districts. Although none of these entities will experience any change in overall revenue, cities, and to a lesser extent counties, will receive a smaller share of the property tax than they do today. In addition, the property tax revenue allocated to K-14 districts will reduce the state's education costs.

APPENDIX 2:

PROPERTY TAX AND LOCAL GOVERNMENT PUBLICATIONS

Property Taxes

Property Tax Agents at the Local Level in California: An Overview (June 20, 2012)

Discusses the role of property tax agents in appealing property assessments.

Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes (February 3, 2000)

Examines the problems in the current property tax allocation system and discusses the tensions and trade-offs inherent in five reform proposals.

Reversing the Property Tax Shifts (April 2, 1996)

Explains the mechanics of the Educational Revenue Augmentation Fund shift and the formulas which implemented it.

Local Finance

Major Milestones: Over Four Decades of the State-Local Fiscal Relationship (November 29, 2012)

Provides a timeline summarizing major changes in the state-local relationship.

Local Government Bankruptcy in California: Questions and Answers (August 7, 2012)

Addresses some common questions about the Chapter 9 process for local governments.

The 2012-13 Budget: Unwinding Redevelopment (February 17, 2012)

Reviews the history of redevelopment agencies, the events that led to their dissolution, and the process communities are using to resolve their financial obligations.

The 2011-12 Budget: Should California End Redevelopment Agencies? (February 8, 2011)

Examines the Governor's proposal to end redevelopment.

Ten Events That Shaped California State-Local Fiscal Relations (December 16, 2009)

Discusses key events and measures that influenced state-local relations.

Overview of California Local Government (June 17, 2010)

Summarizes key issues related to local government.

Understanding Proposition 218 (December 17, 1996)

Examines the constitutional requirements related to property assessments and fees.

LAO Publications

This report was prepared by Chas Alamo and Mark Whitaker, and reviewed by Marianne O'Malley. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

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