

June 4, 2004

Honorable Mayor and Councilmembers:

Imagine that it is June 4, 1978. You are a member of the Woodside Town Council and you and your colleagues are awaiting the outcome of the pending statewide election on which will appear the dreaded Proposition 13. You know that your experience as a municipal leader is about to be significantly influenced should the measure pass. You have read about the expected impact of the infamous tax-slashing initiative: property tax revenues, the Town's bread and butter, will be cut back by as much as fifty percent. Life used to be so simple.

Just last year when you and your colleagues considered and adopted the 1976-77 Town budget, you set your program and service priorities, estimated how much revenue the Town would receive from all sources of revenue other than property taxes, and determined that you would need to raise \$184,020 in property taxes to balance the budget. The Town's total assessed value according to the County Assessor was \$41,822,700. By law, your Council could set whatever tax rate you needed to raise the funds to support the budget. Rates were set per \$100 of assessed value, so a quick multiplication act later, you determined that a rate of 44¢ per \$100 of assessed value would provide the Town the desired \$184,000. Voila!

Things had been going so well. In the last three years the real estate market had gone nuts and the County Assessor had been very busy adjusting the assessed values of all the properties in Town accordingly. The assessment roll had grown from \$31.7 million in 1973-74 to the current \$41.8 million, a 31.9% increase in just three years. You and your colleagues had actually been able to reduce the tax rate from the 46¢ rate set in 1973-74, and still bring in an additional \$38,000 to spend. What was life post-Proposition 13 going to be like? If only you had a crystal ball!

It is very likely that you would have declared your crystal ball broken had you had one to gaze into. What you would have seen looking forward twenty-six years to June 4, 2004 would have been too incredible to believe: California cities, once in control of their own fiscal destinies, striking a bargain with the Governor and handing over hundreds of millions of local revenue dollars for the next two years in exchange for a promise of future fiscal stability. What on earth had happened?

The answer is that things had run amuck. Why did they run amuck? A brief history lesson may be helpful.

### **A Glimpse of the Past: The City/State Fiscal Relationship**

Way back in 1910, during the Progressive Era in California, voters approved a ballot initiative known as the "Separation of Sources Act." This act granted local governments exclusive control over property taxes, which were the primary source of public revenue at that time. The doctrine underlying the Act was based upon the premise that the fiscal powers of local governments should be aligned with their responsibilities. This Act became increasingly more important over time, as the State preempted local

government authority to tax motor vehicles in 1935 and local sales tax authority in 1955. In both cases, the State created substitute tax systems that it controlled and from which it provided local governments a share of the proceeds (motor vehicle license fees and one cent of the uniform sales tax). While the State enacted these preemptions in order to eliminate the chaos that had developed across the State from the confusing and irregular local tax systems and attempted to make local governments whole by allocating back a portion of its new tax base, the taxing authority of local governments was forever eroded as a result.

Beginning in the 1970's, the real estate market heated up and home values experienced unheard of increases practically overnight. Because county assessors were charged with the responsibility to adjust the assessment rolls for all properties to reflect approximate current values, the assessed values of individual properties were experiencing meteoric increases and their owners were facing huge jumps in their tax bills without any obvious increase in services. At the same time, things were going well in Sacramento and the State had amassed a huge \$5 billion budget surplus. By the mid-1970's, Howard Jarvis and Paul Gann had launched their taxpayers revolt and vowed to bring an end to what they saw as overtaxation. While the two were gathering signatures for their ballot initiative, the State Legislature finally decided that something in the system was broken and in its usual "too little, too late" fashion, placed its own tax initiative on the June, 1978 ballot in an attempt to assuage the angry outcries for tax reform with a less devastating approach. Despite the Legislature's attempts and local governments' pleas for mercy, the voters overwhelmingly passed Proposition 13, also known as the Jarvis-Gann Initiative, on June 6, 1978.

Proposition 13 called for a constitutional amendment that placed severe limitations on the property tax system. First, it rolled assessed values back to where they had been in 1975-76, which for many local jurisdictions was a cruel blow in itself. Second, it limited the total tax levy to one percent of the total assessment roll value, with an exception only for voter-approved bonded indebtedness. Third, it gave the State the power to determine how the one percent levy would be distributed to the various local government agencies impacted by the measure, which included cities, counties, school districts, and special districts. Fourth, it established a requirement that new local taxes could not be raised without a two-third's voter approval. The total amount of property tax revenue produced in the first year after Proposition 13 was over fifty percent less than what had been supporting local agencies' services the year before its passage.

The complexion of State and local government fiscal relationships irrevocably changed on June 6, 1978. Although we at the local government level like to charge that the State has raided our local property taxes, property taxes in essence ceased to be a true locally-controlled revenue source on that fateful Tuesday. The State was given distribution control, which is basically the whole enchilada. How did the State react to the passage of Proposition 13?

Within forty-eight hours of Proposition 13's passage, then Governor Edmund G. Brown, Jr. declared a hiring freeze at the State level and vowed to cut State expenses in order to increase the available State surplus. "The more money we can save at the state level, the more we can share with local governments..." Brown told a joint session of the State Legislature on June 8, 1978. He also called for the State to share its surplus

with local governments to ease the local burden. In reaction to the Governor's declarations, then Assemblyman Leo McCarthy, the top-ranking Democrat, suggested that the first programs to be cut should be the Governor's pet programs, including a space satellite and a three-year reforestation program. Things were obviously going to get interesting.

The first solid response to come from the State was SB 154, known as the "bailout bill" and designed to shield local governments from the full effect of Proposition 13 the first fiscal year it was effective, which was 1978-79. The State allocated its surplus to local governments, providing funds in proportion to how much each agency had lost as a percentage of the Statewide loss. The next step was taken in 1979-80, with the passage of AB 8, the "permanent" solution and bailout scheme. The State was continuing to experience an annual budget surplus, which had in fact been increased because of Proposition 13 (State income tax revenue received a \$1 billion windfall caused by the loss of a substantial portion of the property tax write-off for taxpayers). Under the provisions of AB 8, the State used its surplus to significantly increase direct school aid (which had been established following the 1971 *Serrano v. Priest* California Supreme Court decision). The schools' proportional share of the post-Proposition 13 property tax pool was reduced and the pool was then proportionally distributed to all remaining local agencies based upon the last legally levied tax rates. Thus, if the combined tax rate for all taxing agencies in the Town of Woodside had been \$2.50 per \$100 of assessed value in 1976-77 and the Town accounted for 44¢ of the total, then the Town would have been entitled to roughly 17.6% of the property tax pool remaining (the Town's share is actually 4.9%). The obvious inequity inherent with this scheme is that it rewarded those agencies that had increased its tax rate or held it flat in 1976-77 and punished those agencies (like the Town of Woodside) that had reduced the tax rate.

The State included what was called a "deflator" provision in AB 8, which simply said that if State revenues were insufficient, then the State costs would be offset by an equal reduction in local agencies' revenues. Unfortunately, the State's heady budget surplus days did not last and local governments covered under the threat of triggering of the AB 8 deflator until it was permanently repealed in 1984 in tandem with the elimination of the local government personal property tax subvention, an early version of today's motor vehicle license fee backfill. To make up for the loss of the personal property tax "backfill", a larger share of motor vehicle license fees were allocated to local governments. This local government share was constitutionally guaranteed by the passage of Proposition 47 in 1986. The proposition unfortunately did not constitutionally guarantee the level of the fee, just how much of whatever was raised belonged to local governments (fifty percent of nothing is nothing).

As the tenth anniversary of Proposition 13 approached, the fiscal relationship between the State and local governments resembled a poorly repaired hole in a roof. Random planks had been nailed at odd angles across the hole, the nails were rusting, and the water was slowly dripping in and starting to erode the interior. By the time the Gulf War began in the early 1990's and the economy was in deep pain, the masks were off and the State, that once magnanimous protector of local government, showed its new and, perhaps, true inner self: predator of local government revenues. Bound by Proposition 98 to guarantee school funding levels, the State threw a new brand of chaos into the system by shifting a portion of each local agency's property taxes to the Educational

Revenue Augmentation Fund (ERAF), thereby allowing the State to meet its Proposition 98 requirements by shifting the funding burden. The State used the ERAF trick twice in the early 1990's and today, twelve to thirteen years later, local governments across the State are still missing a piece of the property tax base promised by AB 8, the "permanent" solution. The Town of Woodside is missing over \$225,000 in property tax revenues today, lost to the ERAF.

In more recent times, the State has put the spotlight upon the motor vehicle license fee, repealing a part of it in good times and promising to make local governments whole from once again fat State budget surpluses. The recent history is still fresh and does not need recounting, except to note that the State currently owes the Town of Woodside alone over \$98,000 for motor vehicle license fee "backfill" revenues not received in the current fiscal year. No worry there though: we have the Governor's word that a check for \$98,000 is in the mail, but since the postage is a little light the mail will not be delivered until 2006-07.

So, it is later in the day on June 4, 1978, and you are still a member of the Woodside Town Council. What conclusions have you drawn now that you know that your crystal ball is absolutely square on? Here is some food for thought:

- ✓ The ballot initiative process has been around for a long time and successful initiatives do not always spell disaster – some are thoughtful and absent of negative passion (the 1910 Separation of Sources Act).
- ✓ Government leaders at all levels (and their top staff advisors) are not always tuned into the sentiments and frustrations of their constituencies and this failure clearly led to the successful passage of Proposition 13, a very poorly written constitutional amendment that has created its own extreme inequities, has unraveled local governments' ability to link responsibility with fiscal authority, and has created what appears to be a continually degrading respect for government in general.
- ✓ Despite evidence to the contrary, the State is not always the devil in every fiscal scenario: we must all accept culpability for how things have evolved (and I do not just mean those of us in government).
- ✓ One of these days we shall have to address the inequities in the property tax system that are a direct result of the Taxpayers' Revolt of 1978. There is no way to justify today's reality, whereby the owners of two identical properties pay dramatically different property tax bills for exactly the same local services. Something will snap one of these days.

Having moved into and out of my role as local government historian (this is my 27<sup>th</sup> local government budget), I now transmit to you, the members of the 2004 Woodside Town Council, the 2004-05 Proposed Budget.

The budget document that this letter transmits is a \$5.2 million expenditure plan designed to address the Town Council's priorities and to be in compliance with the Town Council's Financial Management Policies. With the exception of about \$179,000 in added program costs, this budget mirrors the second year of the two-year budget approved by the Council in June of 2003. Within the Town's General Fund, the League of California Cities' handshake deal with the Governor is incorporated and a few new

expenditure items are included to address added priorities or resolve newly discovered issues.

### **The Impact of the State's Fiscal Situation**

A deal has been crafted between the Governor and representatives of the League of California Cities, as well as other local government representatives. Perhaps the Governor's desire to do this deal stems from the fact that a ballot initiative has qualified for the November, 2004 election that would provide protections for local government revenues and place them out the reach of the long arm of the State, unless a vote of the people dictate otherwise. Perhaps the Governor is shrewd enough and popular enough to know how to craft a workable blend of budget deals that will get the State through the next two years. Perhaps there really is a Tooth Fairy. Whatever the case, the fact is that a deal exists and that deal needs to make it through the Legislature.

A second fact exists: Proposition 57 on the March, 2004, ballot passed and the State now has the authority to issue up to \$15 billion in bonds to pay off past years' deficits and to fill in portions of next year's deficit. Both of these facts impact the Town's budget for 2004-05.

The first fact - the "deal" - will reduce total Town revenues by about \$78,000 in both 2004-05 and 2005-06. What has been proposed is the permanent reduction of a significant portion of the motor vehicle license fee and the elimination of the guaranteed State backfill to local governments. To make local governments whole, ERAF funds equal to the lost motor vehicle fee backfill funds will be shifted back to local governments. For the Town, this translates into a loss of \$286,592 in motor vehicle license fees in 2004-05 and the receipt of the same amount of new revenue from the ERAF. The exception, of course, is that for 2004-05 and 2005-06, the Town will not receive about \$78,000 of this new revenue. The State will use it to make its house less "unwhole" and will stop taking these funds in 2006-07, when things are going to be much brighter for the economy in general and the State in particular. The State will also pay local governments back for the motor vehicle license fee backfill revenue it did not provide in the current fiscal year. For the Town, this is about \$98,000. Finally, the quid pro quo for local governments' acceptance of the deal is that the Governor will support a constitutional amendment that removes the State's ability to reshuffle the local revenue deck whenever its fiscal needs demand. We shall see what we shall see. The proposed budget does, however, reflect the reduction of a net \$78,000 in General Fund revenues, per the deal, and the five-year forecast includes this reduction again in 2005-06. The \$98,000 "payback" in 2006-07 of lost motor vehicle license fee backfill revenue is not factored into the five-year plan, based upon the Town Council's Financial Management Policy that dictates that revenues not be budgeted unless there is reasonable certainty that they will be received. The jury is still out.

The second impact from the State is a supposedly revenue neutral event dubbed the "Triple Flip." Under the Triple Flip, the State will divert ¼¢ of local sales tax to pay for the debt service on the Proposition 57 bonds. The State will then divert an equal amount from school district property taxes (the old AB 8 formula) to local governments to make them whole. Next, an equal amount of State general fund monies will be redirected to the schools to likewise make them whole. Although this scheme is

effective on July 1, 2004, its impact will not be seen until September and its actual impact, given cash flow differences between sales tax receipts and the timing of property tax distributions, remains to be seen. The proposed budget includes no changes based upon the Triple Flip. When it is actually implemented, a review of its impacts will be scheduled for the Town Council and needed adjustments recommended.

### **Issues for 2004-05 and Beyond**

This is the second year of a two-year budget that has already been reviewed by the Town Council. It includes a few additions that bear discussion and it is notable for its continuing fiscal integrity, despite State budget deals and the recommendation to spend additional funds. The total net Town budget is \$5.2 million. It fully funds all Town Council approved programs and commitments. The General Fund portion of the budget amounts to \$3.5 million. It is not only balanced, but adds to General Fund reserves and supports several recommended undertakings not heretofore included in the spending plan. The budget is based upon conservative revenue estimates, given the state of the health of the economy, and it does not use reserves to support any of its funded programs.

Those expenditure proposals that bear Town Council discussion are:

- ✓ **Fire Management Plan Implementation:** The Town Council received the Fire Management Plan during the current fiscal year and is scheduled to receive a last chapter of findings and recommendations on June 14<sup>th</sup>. Although the Plan has not been adopted by the Council, one of its recommendations deserves immediate implementation and requisite funding. The Town needs to proactively clear fire fuels in the form of brush and tree debris from its rights-of-way. While annual brushing is currently done, it is not sufficient to remove the debris that has formed and that constitutes a fire fuel threat. A \$30,000 allocation is included in the proposed budget to support the hiring of crews to start an annual fire fuel clearance program on property for which the Town is responsible. This may not be a sufficient amount. The staff will work to secure the assistance of San Mateo County Firesafe crews and utilize Sheriff work crews to the greatest degrees possible. As experience is gained, requests for additional funds may be submitted for Council consideration.
  
- ✓ **Security Patrols:** The Town has received reports of activities on Town-controlled lands that may represent a fire threat or some other form of public nuisance. Although the Sheriff's personnel respond to calls when there are situations, there are not sufficient resources to proactively patrol the areas that are the subject of the reports. A pilot project is proposed, supported by \$5,000, through which a private security firm is engaged to make regular patrols of impacted areas, implanting a clear presence and discouraging the activities seen as threatening to public safety. The results of the pilot project, which would take place over a several month period, would be evaluated for effectiveness and possible continued funding.

- ✓ **Management Audit of the Engineering Function:** The Town has invested funds in the past to secure an evaluation of the workings of its Planning Department. Such a review is now proposed for the engineering function of the Public Works Department. A proposal has been solicited from a firm that specializes in management and organizational reviews. A team consisting of a civil engineer and a layperson would evaluate the Town's development services activities that involve the engineering function and identify improvements that can be made to improve aspects of processing and/or streamline the submittal requirements. Funds are included in the proposed budget for this review, in the amount of \$25,000. This review is timely, given the need for the Town's engineering staff to oversee the construction of Barkley Fields and Park, which will hopefully get underway this upcoming fiscal year, barring litigation.
  
- ✓ **Fee Schedule Review:** The Town's fee schedule has not been reviewed or updated since 1994-95. It is possible that fees may either be under-recovering costs or over-recovering costs. A full review of the schedule and the basis for the existing fees is warranted and is, in fact, supported by State law that dictates that fees recover only actual direct and indirect costs. The Town has a proposal in hand from a firm that is well-qualified to do this review. It requires the one-time allocation of \$25,000.

No other new proposals or expenditure requirements are included in the proposed budget. There are projects that will require the Town Council's appropriation of funds after the new fiscal year has begun and sufficient information is available about timing and scope. Included in this category are: (1) the Barkley Fields and Park project, which recently received its approvals from the Planning Commission; (2) the Library Parking Lot and Landscaping Improvement project, which is still the subject of discussions between staff, the neighboring property owner, and the Woodside Landscape Committee; and (3) the full adoption and implementation of the Fire Management Plan.

There is another busy year ahead, full of positive undertakings and its share of daily frustrations. My staff and I are bound and determined to make projects that are only currently in the planning phase a reality for the residents of the Town. I look forward to budget discussions and to another year of working with and for the Town of Woodside. My thanks to each member of the Town Council, to my wonderful staff, and to the best Planning Director that the Town of Woodside has ever known – Hope Sullivan. You are one terrific person. Don't ever doubt the difference you have made and continue to make!

Respectfully submitted,

Susan George  
Town Manager









