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To: Councilman Jim Madaffer, Chair and Members of the Public Safety and Neighborhood Services Committee

From: Andrew Poat, Director
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Date: February 25, 2005

Re: Proposition 172 – Public Safety Revenues
Agenda of March 2, 2005

This memo provides:

- Brief history of Proposition 172 and its funding formulas
- Policy options for the Council relative to distribution of Proposition 172 funds

BACKGROUND

Proposition 172 (Safety Sales Tax) was passed by California voters in 1993 and took effect January 1, 1994. The initiative's purpose was to provide local governments with a dedicated revenue stream (one-half of one percent of state sales tax) for public safety to offset part of the $2.3 billion in county and city revenue losses that were incurred by the Educational Revenue Augmentation Fund (ERAF) shifts in FY 1992-93 and FY 1993-94), which continue today.

Local governments, opposed to the cuts, argued successfully that the reduction in local revenues would have a significant negative impact on public safety services. Then Governor Wilson and the Legislature agreed to make permanent through an amendment to the Constitution, a ½ percent sales tax and dedicate it solely to public safety.

Subsequent statute distributes the sales tax revenue based upon local governments' 1993-94 proportionate loss of Property Tax revenue to ERAF. Proposition 172 revenue is first allocated to counties based on each counties proportionate share of statewide taxable sales. Within each county, the revenue allocations to each city and to the county are then based on the proportionate property tax loss to ERAF in 1993-94. Under the initial ERAF shifts, County governments contributed significantly higher percentages of property taxes than City governments. As directed by State law, the State Controller's Office disburses Safety Sales Tax revenue to the County Local Public Safety Fund for distribution. Cities receive approximately five percent of the amount in the Fund. In 1996, Senate Bill 8 changed that allocation in San Diego County – directing 94.35% of funds to the County with the remaining 5.65% to the 18 cities in the County. The City of San Diego receives approximately 3.18% of total County-wide Proposition 172 funds. In Fiscal Year 2005, the City has budgeted approximately $6.7 million in Proposition 172 revenue. According to the Legislature's analysis (attachment 1), SB 8 was an agreement between local agencies in San Diego County.

Proposition 172 now generates approximately $200 million annually for the region – with annual growth in the range of $6 million. Statewide, revenues approach $2.5 billion - with Counties receiving $2.15 billion (94%) and cities receiving $350 million (6%).

Analysis & Options

Discussion of Proposition 172 distribution formulas has occurred intermittently – both in San Diego and other parts of the state. Two initiatives have actually taken shape:

Santa Barbara County

In July 2004 the County of Santa Barbara voluntarily decided to incrementally increase their allocation of Proposition 172 funds to their County Fire Department over a five-year period. This did not change the distribution formula between the County and the other cities, but simply amended the County's distribution of their 95% share and was achievable by an affirmative vote of the Board of Supervisors.

Orange County Fire Authority

In a different effort and without the support of the local Board of Supervisors, the Orange County Fire Authority (OCFA) has qualified an initiative for the November 2005 ballot which would change the countywide allocation of Proposition 172 in that county alone. The measure states that despite the County receiving $1.8 billion in Proposition 172 funds since its creation, none of the funds have been allocated to the OCFA.

The OCFA's ballot measure would require the Orange County Board of Supervisors to reallocate the annual growth in Proposition 172 revenues. Beginning in FY2005 – 2006, 50% of revenue growth will be allocated to the OCFA and the remaining 50% plus the base year funding amount will be allocated to other eligible public safety providers. This distribution shall take place each year an increase in funds over the base year occurs and until such time as the OCFA's allocation equals 10% of the County's share.

This measure does not require statewide approval as it only amends Orange County's portion of Proposition 172 funds and does not reallocate the entire region's distribution schedule.

From the broadest policy perspective, the San Diego City Council has four options:

1. *Accept the Status Quo:* Proposition 172 funds are distributed based on a formula to which the City agreed in 1996. That ratio reflects the disproportionate share of revenue reductions faced by the County due to early ERAF shifts. Though that ratio has now changed, the County will argue that the funds are well spent on important public safety purposes – and, that non-ERAF budget reductions have also disproportionately hurt Counties.

2. *Study recalculation of distribution Formulas:* An additional two-year ERAF shift has occurred (FY 2004 – 05 & FY 2005-06 since Proposition 172 was enacted. Today, the disparity between the contribution from cities and counties to ERAF has been reduced, if redevelopment funding is considered.

	Counties Amount		Cities & Redevelopment Amount	
ERAF I & II	$3.95 billion	83%	$832 million	17%
ERAF I, II & III	$4.65 billion	75.6%	$1.5 billion	24.4%
Prop 172 Funds	$2.35 billion	87%	$350 million	13%

IT MUST BE NOTED THAT WHILE ERAF I & II WERE PERMANENT, ERAF III IS RESTRICTED TO FISCAL YEARS 2005 AND 2006. BEGINNING IN 2007, THE DISTRIBUTION OF CUTS WILL AGAIN RETURN TO THE PROPORTION NOTED ERAF I & II ABOVE.

Options include:

- Reallocate base Proposition 172 revenues to reflect actual ERAF contribution totals
- Reallocation of revenue "growth"

3. *Change distribution to consider services provided vs. revenues shifted*

As written, Proposition 172 funding is distributed based on property tax shifts of a decade ago. Under that distribution, no consideration is given to the types of services provided by local jurisdictions. Counties in many parts of California provide fire services of some kind – and thus benefit from Prop 172 revenues. In San Diego County, fire protection services are delivered by individual cities and fire protection districts. The County of San Diego does not operate a regional fire department and instead dedicates it's 94.35% of funds between law enforcement and prosecutors.

4. *Seek complete re-write of Proposition 172*

As discussed previously, the measure was written in 1993 to address the revenue shifts occurring at that time and in response to local governments' stated concern of negative effects on local public safety services. Considerable changes in local government financing, and needs, have transpired since that time. Indeed, the Council may wish to entertain moving the distribution formula completely away from the ERAF impact formula to some needs or priority based allocation. Options include:

- Broadening permissible purposes
- Re-evaluating public safety purposes, including homeland security and appropriate allocation to fire services

Methods of Reallocation

Amending the distribution of Proposition 172 funds among regional agencies can be achieved through either of two options:

1. Statewide Legislation – Introduction of legislation can occur to either permanently or temporarily modify the distribution formula for Proposition 172. Because a measure of this nature would amend only an action related to allocation of tax revenue, not a change of the State Constitution or a new tax levy, the bill would require a majority vote of the legislature to pass.

2. San Diego Specific Legislation – As an alternative to statewide legislation, a bill could be introduced to change the distribution formula in San Diego County only. Because it does not amend the provisions of the statewide election, a measure of this kind could be passed with a majority vote.

To amend the permissible purposes of the funds, or completely re-write Proposition 172, a constitutional amendment would be necessary. Two methods are available for such an approach:

a. Legislature – The Legislature could place a new constitutional amendment on the ballot to change the allocation formula of Proposition 172. This process requires a constitutional amendment be heard and passed by a 2/3 vote of the Legislature to appear on the next statewide ballot.

b. Voter Initiative – Two options exist in this category:
    i. Amend the constitution to change the distribution of Proposition 172 funds, thereby providing stronger protection for the new allocation formula. To qualify a constitutional initiative, the proponents must collect signatures of valid registered voters equal to 8% of the votes for all candidates for Governor at the last gubernatorial election.

    ii. Place a statutory amendment on the ballot to change the distribution. A statutory change does not provide strong protection for the new formula as it can be changed by the Legislature with a 2/3 vote. To qualify a constitutional initiative, the proponents must collect signatures of valid registered voters equal to 5% of the votes for all candidates for Governor at the last gubernatorial election.

CONCLUSION

Local governments have dramatically improved their protection against revenue raids with the passage of Proposition 1A in 2004. Unfortunately, no fewer than three, multi-year property tax shifts occurred prior to that protection being adopted by voters. Since 1992, the State has been confiscating local property taxes from local governments that total over $5.3 billion statewide – over $340 million alone from the City of San Diego through Fiscal Year 2004. Were these reductions not made, the City would have $41 million ANNUALLY for enhanced General Fund activities - 54% of which is spent on public safety.

$41 million is:

- larger than the entire trash collection budget ($35 million)
- larger than the entire library budget ($38 million)
- 59% of last year's entire Park and Recreation budget ($73 million)
- 33% of last year's entire Fire department budget ($124 million)
- 15.2% of last year's entire Police department budget ($270 million)

In the final analysis, the property tax shifts implemented by the State have posed a significant challenge to both the City and County of San Diego. Proposition 172 provides partial relief for these significant property tax shifts – but addresses the full needs of neither entity. There is little doubt that both City and County expenditure of Proposition 172 funds benefit taxpayers. The important policy question is: what is the best use of these funds?

This report provides an analysis of past policy decisions with the hope of illuminating future policy discussions relative to confirming the future uses of this revenue stream, or proposing modifications thereto.

ATTACHMENT 1: SB 8 – San Diego Allocation of Proposition 172 Revenues

BILL ANALYSIS

SENATE THIRD READING
SB 8 (Peace)
As Amended August 29, 1996
Majority vote

LOCAL GOVERNMENT	9-0	APPROPRIATIONS	18-1
		Ayes: Poochigian, Brown, Ackerman, Aguiar, Archie-Hudson, Baldwin, Bordonaro, Brewer, Cannella, Friedman, Gallegos, House, Martinez, Morrissey, Olberg, Takasugi, Villaraigosa, Woods Nays: Thompson	

SUMMARY: Modifies the allocation formula in San Diego County for public safety funds (Proposition 172) beginning in Fiscal Year (FY) 1997-98.

Specifically, this bill removes the:
1) 5% cap imposed on the Public Safety Augmentation Fund (Fund) allocations for certain cities' total share and establishes allocation factors for cities in the county of San Diego.

2) Requirement that the allocation factor, for the Fund, for certain cities in the county of San Diego in FY 1993-94, shall not result in an allocation that exceeds 50% of the difference between the following:
a) The amount which the city's allocation of property tax was reduced and shifted to the Educational Revenue Augmentation Fund (ERAF); and b) the amount of the vehicle license fee revenues allocated to that city.

FISCAL EFFECT: State-mandated local program; transfers nearly $1 million from the San Diego County Fund to 14 cities in FY 1997-98.

EXISTING LAW:

1) Requires, under the California Constitution, the imposition of a 1/2 cent sales tax and the deposit of that tax into the Local Public Safety Fund (LPSF) for the purposes of funding local public safety programs.

2) Requires the county auditor to determine the allocation of the Fund for cities, in FY 1993-94, and shall not result in an allocation that exceeds 50% of the difference between the following: a) the amount which the city's allocation of property tax was reduced and shifted to ERAF; and b) the amount of the vehicle license fee revenues allocated to that city.

3) Imposes a 5% cap on the total share of the Fund for cities in the counties of Fresno, Kings, Merced, San Bernardino, San Diego, San Joaquin, Solano and Yolo.

BACKGROUND: Proposition 172, enacted by the voters in November 1993, extended and earmarked for public safety purposes an existing 1/2 cent sales tax which previously went to the state's General Fund. Proposition 172 was placed on the ballot by the Governor and the Legislature specifically for the purpose of partially back-filling the shift in property tax revenues from local agencies to ERAF.

In 1993-94, the property tax shift from local agencies to ERAF was structured as follows: counties lost $1.998 billion, cities lost $288 million, special districts lost $244 million and redevelopment agencies lost $65 million. An effort ensued during budget negotiations to minimize the impact of the shift for certain counties which absorbed a disproportionate share of the ERAF impact [SB 509 (Budget Committee), Chapter 73, Statutes of 1993 and AB 1519 (Isenberg), Chapter 905, Statues of 1993]. The current formula for allocating Proposition 172 revenues to cities in San Diego County (and seven other counties) includes two limitations: the 5% cap on the total share received by cities and an absolute dollar limit based upon 50% of the cities' net property tax loss in FY 1993-94. This latter limitation applies to all counties in California.

San Diego County officials estimate sales tax growth to increase in the range of 3.5% to 4.5% annually over the next six years. Cities have felt that the limitations imposed are unfair and have negatively impacted their public safety programs. Allocation factors established in this bill raise the cities' total proportionate share of Proposition 172 funds from the 5% cap to nearly 5.65%. The 50% cap is removed entirely which would allow cities to share in that projected growth. By removing the allocation caps, cities will receive funds beyond the total dollar limit of $6.4 million created by the 50% provision.

Similar legislation, AB 1191 (Takasugi), pending in the Assembly, removes the 50% cap which allows cities to participate in the growth of sales tax. AB 1191 incorporates this bill's language and specifies that if both bills are chaptered, that AB 1191 will be chaptered last. The most recent amendments correct a chaptering out provision to coincide with AB 1197 to ensure the implementation date of FY 1997-98 for both bills.

ARGUMENTS IN SUPPORT: This bill provides a more equitable allocation of local public safety funds within San Diego County. This bill represents a negotiated agreement between the county and the cities within San Diego County. This negotiated agreement will allow cities to receive a greater share of LPSF and will assist in providing police, fire, and emergency services. Proponents argue that this bill will return funds to the cities which generate those revenues and improve public safety in each of the communities (e.g., Carlsbad, Chula Vista, Coronado, Del Mar, El Cajon, Escondido, Imperial Beach, La Mesa, Lemon Grove, National City, Oceanside, San Diego, San Marcos, Vista).

ARGUMENTS IN OPPOSITION: None
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