

**TO: HONORABLE CITY COUNCIL**

**FROM: CITY MANAGER DEPARTMENT: CITY MANAGER'S OFFICE**

**DATE: MAY 11, 2009 CMR: 243:09**

**SUBJECT: Adoption of a Resolution Opposing the State Department of Finance's Proposal to "Borrow" Local Government Property Taxes to Reduce the State's Budget Deficit for FY2010**

**RECOMMENDATION**

Staff recommends that the Council adopt the attached resolution (Attachment A – to be distributed Monday, May 11) opposing the State Department of Finance proposal to “borrow” 8% of local government property tax revenues in FY2009 to reduce the State’s budget deficit for FY2010.

**DISCUSSION**

On May 5, 2009, the State Department of Finance issued a proposal (Attachment B) to the Governor that the State suspend Proposition 1A (passed in 2004) and borrow 8% of local governments’ property tax revenues and the triple flip sales tax allocation. These revenues can be borrowed by the state and repaid within three budget years with interest. The amount that can be borrowed is determined by the amount of property taxes received by cities, counties, and special districts in the preceding year. Borrowing from local government in FY2010 would provide approximately \$2 billion of local revenues to the State.

This one-time solution to the State’s ongoing structural budget issues puts the burden on local governments and citizens who will have to address this revenue shortfall in addition to the local financial challenges already being faced. Cities throughout the State have already enacted painful cuts to balance their own budgets—including layoffs, furloughs, reduction of services, and project and maintenance delays. Palo Alto faces a budget deficit of \$8 million in FY2009 and a deficit of \$10 million in FY2010. A loss of additional property tax revenue could mean even deeper cuts in services to our local residents.

The DOF proposal is fiscally irresponsible. Financing the State budget deficit with borrowing from local governments will only deepen the State’s structural deficit. The State is obligated to repay the property taxes with interest within three years. However, borrowing does nothing to

address the structural budget issues currently facing the State. The State must figure out a method for balancing the budget using its own resources.

City staff have been coordinating with the League of California Cities on a resolution opposing this proposal. Staff will provide this resolution and any additional information to the Council on Monday. It is important to note that the proposal has not been endorsed by the Governor at this point. Any resolution of the Council would make it known that the City opposes this proposal and encourages the Governor to reject it. Additionally, staff will work with the League of California Cities on other advocacy measures related to this issue and will keep the Council apprised of upcoming actions.

### **RESOURCE IMPACT**

The adoption of this resolution by the Council does not have a resource impact. However, the proposal put forth by the State Department of Finance to “borrow” 8% of local government property tax revenues could have a significant impact on the City of Palo Alto. The proposal would take 8% of property VLF **and** the triple flip sales tax.

According to the 2010 budgeted revenues, the impact on the City of Palo Alto is:

Property Tax (includes VLF)	=	\$2.00 million
Triple Flip (1/4 of sales tax)	=	\$0.43 million
<b>Total</b>	=	<b>\$2.43 million</b>

Given that the City is already facing a budget deficit of \$8 million in FY2009, this proposal would have a dramatic impact on Palo Alto services. It would force the Council and staff to reevaluate proposed cuts for FY2010 and determine which additional cuts to public safety and community services would need to be made. This could force the City to actually implement the worst case scenario Tier 2 cuts as identified in the City Manager’s April 27 and May 5 budget presentations and identify additional reductions if the Council does not agree with the “bridge” recommendation. This could result in additional proposed reductions, such as:

- Contracting out park and golf maintenance efforts
- Eliminating the City’s Police traffic team
- Ending City shuttle service
- Elimination of the Police School Resource Officer program
- Eliminating the tree trimming contract
- Eliminate Office of Emergency Services (OES)
- Reduce Crime Analysis program
- Reduce Community Policing/Outreach program

The City Manager is already proposing to reduce City staffing by 20.5 positions for FY2010. These additional reductions could result in elimination of another 21 positions and employee layoffs. If the City's revenue outlook worsens, staff may need to identify even further reductions to programs and staffing above and beyond those outlined. The proposal by the State Department of Finance could have devastating impacts on the City when we are already challenged by the current economic climate.

**POLICY IMPLICATIONS**

This action is consistent with the Council's priority of Economic Health and the Council legislative guideline to protect local revenue sources.

**ENVIRONMENTAL REVIEW**

This report is not a project requiring review under the California Environmental Quality Act (CEQA).

**ATTACHMENTS**

Attachment A: Resolution of the Council of the City of Palo Alto Opposing the State Department of Finance's Proposal to "Borrow" Local Government Property Taxes to Reduce the State's Budget Deficit for FY2010 (to be distributed on Monday, May 11).

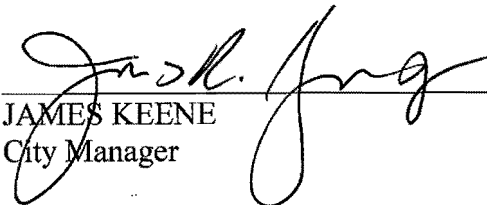
Attachment B: State Department of Finance proposal outline

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**FOR IMMEDIATE RELEASE**

**Californians' Safety Threatened by Proposal to Borrow Local Property Taxes**

**Sacramento, CA** — Today the Department of Finance informed local officials they have prepared a May Budget Revision option for the Governor to consider that borrows 8 percent of local governments' property tax revenues, estimated at just over \$2 billion, to help close the state's budget deficit. The proposal will threaten the safety of every Californian. The League will strongly oppose any proposal that puts the funding of state government ahead of the public safety of city residents.

"This proposal is irresponsible and would have disastrous and long-lasting impacts. Cities are already reducing services due to the recession and can't afford to cut public safety and other essential services to bail the state out," said League President and Rolling Hills Estates Mayor Judy Mitchell.

Chris McKenzie, League Executive Director, added: "For most cities police and fire protection make up 60 – 80% of their budgets." Californians know how important it is to maintain public safety. According to a Field Poll released April 30, seventy-four percent oppose cuts to law enforcement and police. DOF's proposal significantly increases the likelihood cities will have to cut the very public safety services the voters want protected.

The League called on the Governor to reject the DOF proposal. McKenzie said: "The Governor has said repeatedly that borrowing local property taxes and Prop. 42 transportation funds is irresponsible. It only deepens the state's structural deficit and creates an obligation to repay. In the meantime, local services will be cut severely and citizens' safety will be put at risk. This is precisely the type of budgeting that California needs to avoid. The state needs to balance its budget within its own resources."

The League of California Cities is prepared to fight vigorously to protect city services to the millions of Californians who live in cities.

*Established in 1898, the League of California Cities is a nonprofit statewide association that advocates for cities with the state and federal governments and provides education and training services to elected and appointed city officials.*

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## 2009-10 May Revision Option (Dollars in Thousands)

### Local Government Financing Title: Borrowing from Local Government

	GF	FF	Other	Total Reductions	PY Reduction
<b>2009-10</b>					
<b>Workload Budget</b>					
<b>Reductions</b>	<b>\$2,006,000</b>			<b>\$2,006,000</b>	
<b>Governor's Budget</b>					

#### **Program Description**

The constitution allows that up to 8% of local governments' property tax revenues can be borrowed by the state and repaid within three budget years with interest. The amount that can be borrowed is determined by the amount of property taxes received by cities, counties, and special districts in the preceding year. Borrowing from local government in the 2009-10 fiscal year would provide \$2.006 billion in solutions.

#### **Program Reduction**

An option to address the potential budget shortfall would be to borrow property tax revenues (Proposition 1A, 2004) from local governments.

Local governments could borrow against the state's constitutional obligation to repay, thereby mitigating the impact of this reduction. However, in the current economic landscape, local governments are not easily finding available short term financing and could face difficulties borrowing these funds from the market. If they borrow, local government will incur substantial borrowing costs.

If local governments are unable to borrow or can borrow insufficient amounts, local government may have to make reductions to locally funded services. Property tax revenues are used by local governments for a variety of services including police and fire, waste collection, road maintenance, libraries and other services.

#### **Reduction Impacts**

Specific impacts of this reduction will vary by local jurisdiction and will in part depend on the ability of local government to obtain borrowing from the market. This reduction could result in cuts to locally funded services such as police and fire, waste collection, road maintenance, libraries and other services.

## **2009-10 May Revision Option (Dollars in Thousands)**

Based on a survey of the top 15 California cities in terms of property tax revenue collection estimates (based on 2006-07 collections), if adopted, this option could result in reductions to their budgets, as follows:

Los Angeles	\$67,712,897
San Francisco	\$61,833,541
San Diego	\$20,054,088
San Jose	\$12,810,380
Sacramento	\$7,425,680
Long Beach	\$6,604,224
Oakland	\$6,363,535
Fresno	\$4,607,868
Newport Beach	\$4,475,138
Pleasanton	\$3,202,884
Bakersfield	\$3,071,241
Riverside	\$3,051,165
Fremont	\$3,025,522
Berkeley	\$2,951,759
Huntington Beach	\$2,886,124

Reductions, if not replaced by local borrowing, would come on top of reductions most cities and counties are considering or already budgeting to address shortfalls in local sales and property tax revenues. Finance is estimating property taxes to decline by an average of 4 percent in 2009-10 after growing only about 2 percent 2008-09 and sales taxes are declining by about 15 percent from 2007-08.

Increases in layoffs of police, fire, public health, recreation and other tax supported workers are likely. Due to federal and state laws, counties may have limited ability to reduce costs in some programs where financial responsibility is shared, but they can make some employee compensation reductions and implement other savings. Special districts and cities often have other fees that could be raised to backfill reductions and maintain services. However, basic public protection can generally not be fee supported. Districts that are only property tax supported would face up to 8 percent budget reductions.

### **Timing of Implementation**

The reduction could be legally effective on July 1, 2009, if enacted as an urgency statute. The statute would provide for the timing and mechanism of payment to the state. Locals receive property tax in December and April or shortly thereafter. Taking funds from them before that could cause a local cash crunch and some may simply not pay timely.

### **Statutory and/or Regulatory Change**

The Constitution requires the Governor to issue a proclamation of a severe state fiscal hardship and passage of a separate two-thirds vote bill. The bill should specify how interest will be paid since there is no provision in current law for this and the Constitution requires there be payment of interest provided by law. It is likely locals will ask that their full cost of borrowing be covered by state interest payments.