Hearing Date: January 24, 2014
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ITEM 9

PROPOSED PARAMETERS AND GUIDELINES

AND

STATEMENT OF DECISION

Health & Safety Code Sections 33681.12, 33681.13, 33681.14, 33681.15; Revenue & Taxation Code Sections 97.68, 97.70, 97.71, 97.72, 97.73, 97.75

Statutes of 2003, Chapter 162; Statutes of 2004, Chapter 211; Statutes of 2004, Chapter 610

Accounting for Local Revenue Realignments

05-TC-01

County of Los Angeles, Claimant

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BEFORE THE

COMMISSION ON STATE MANDATES

STATE OF CALIFORNIA

IN RE TEST CLAIM ON: Health & Safety Code Sections 33681.12, 33681.13, 33681.14, and 33681.15; Revenue & Taxation Code Sections 96.81, 97.31, 97.68, 97.70, 97.71, 97.72, 97.73, 97.75, 97.76, 97.77, 98.02 Statutes 2003, Chapter 162; Statutes 2004, Chapter 211; Statutes 2004, Chapter 610 Filed on August 12, 2005 By County of Los Angeles, Claimant.	Case No.: 05-TC-01 *Accounting for Local Revenue Realignment* STATEMENT OF DECISION PURSUANT TO GOVERNMENT CODE SECTION 17500 ET SEQ.; CALIFORNIA CODE OF REGULATIONS, TITLE 2, DIVISION 2, CHAPTER 2.5, ARTICLE 7. (*Adopted September 27, 2013*) (*Served October 2, 2013*)

STATEMENT OF DECISION

The Commission on State Mandates (Commission) heard and decided this test claim during a regularly scheduled hearing on September 27, 2013. Hasmik Yaghobyan appeared on behalf of the County of Los Angeles, Michael Byrne and Susan Geanacou appeared on behalf of the Department of Finance, and Geoffrey Neill appeared on behalf of the California State Association of Counties.

The law applicable to the Commission's determination of a reimbursable state-mandated program is article XIII B, section 6 of the California Constitution, Government Code sections 17500 et seq., and related case law.

The Commission adopted the proposed statement of decision to partially approve the test claim at the hearing by a vote of 5-0, with one member abstaining and one member absent.

Summary of the Findings

The Commission finds that the three revenue realignment programs created by the test claim statutes impose reimbursable activities upon counties to establish new accounts within the treasury of the county, and to reduce and reallocate funds as directed by the statutes, and in amounts identified by the Department of Finance or the Controller, respectively. The Commission finds that the test claim statutes do not, by the plain language, require counties to calculate, or to verify, the amounts required to be reduced during the 2004-2005 and 2005-2006 fiscal years, but that the VLF Swap does require counties to calculate the adjustment amount beginning in the 2006-2007 fiscal year. The Commission finds that none of the statutory exclusions from reimbursement found in section 17556 are applicable to these activities in the 2004-2005 and 2005-2006 fiscal years, but beginning in 2006-2007, all counties, except for the City and County of San Francisco, are authorized by section 97.75 to charge cities within their jurisdiction fees in an amount sufficient to pay for the administrative costs of the VLF Swap and

the Triple Flip required by sections 97.70 and 97.68 of the Revenue and Taxation Code. Therefore, reimbursement for the VLF Swap and Triple Flip must end in the 2006-2007 fiscal year for all counties, except the City and County of San Francisco, because they no longer incur increased costs mandated by the state, by virtue of their authority to charge the incurred costs to cities. However, because the City and County of San Francisco is not relieved of any incurred costs by the operation of the fee authority provided, the City and County continues to be eligible for reimbursement during and after the 2006-2007 fiscal year for the VLF Swap and the Triple Flip.

COMMISSION FINDINGS

I. Chronology

08/12/2005	Claimant, County of Los Angeles, filed the test claim with the Commission on State Mandates (Commission).
06/09/2008	Claimant submitted supplemental information regarding fee authority offsets.
05/30/2013	Commission staff issued draft staff analysis and proposed statement of decision.
06/06/2013	Claimant requested an extension of time to file comments and postponement of the hearing, which was granted.
07/10/2013	Department of Finance submitted comments on draft staff analysis.
07/19/2013	Claimant submitted comments on draft staff analysis.

II. Introduction

This test claim alleges reimbursable state-mandated increased costs on the basis of three statutes, which added or amended sections of the Government Code, the Health and Safety Code, and the Revenue and Taxation Code. Only the Health and Safety Code and Revenue and Taxation Code provisions have been pled. The test claim statutes shifted and swapped revenue in three areas: the Educational Revenue Augmentation Fund (ERAF) established by each county; making the Vehicle License Fund (VLF) Swap permanent; and the "triple flip" of sales and use taxes to service debt payments on State Economic Recovery Bonds, "back-filled" from the ERAF, which was in turn replaced by direct subventions from the General Fund. The end result was a savings to the state of $1.3 billion.[1]

The Role of Property Taxes

Historically, local governments, including school districts, were funded largely by property taxes: the California Supreme Court in *Serrano v. Priest* observed that "by far the major source of school revenue is the local real property tax."[2] But because not every locality is graced with similar property values (i.e., the tax *base*), or a similar degree of ability and willingness to endure increased *rates* on property within the locality, "this funding scheme invidiously discriminates against the poor because it makes the quality of a child's education a function of the wealth of his

[1] Exhibit B, Test Claim Volume II, at p. 165 [Committee Analysis of AB 2115].

[2] *Serrano v. Priest* (*Serrano I*) (1971) 5 Cal.3d 584, at p. 592.

parents and neighbors."[3] Therefore the longstanding reliance on property taxes for school district funding, and the resulting inequality, gave rise to corrective legislative action, in the form of SB 90 (Stats. 1972, ch. 1406), "which established a system of revenue controls that limited the maximum amount of general purpose state and local revenue that a district could receive." A key purpose of SB 90 was to bring higher- and lower-revenue districts closer to the statewide average over time, by applying a differential annual increase in funding to account for inflation (greater increases for lower-revenue districts than for higher-revenue districts). In 1976, the California Supreme Court held in *Serrano v. Priest* (1976) 18 Cal3d 728 (*Serrano II*) that SB 90's corrective efforts had not sufficiently addressed the problem of district wealth disparities leading to disparities in educational quality.[4]

In response to *Serrano II*, the Legislature passed AB 65 (Stats. 1977, ch. 894), which provided for state assistance to poorer districts if their revenues fell below a scheduled amount.[5] But before AB 65 was to take effect, "the voters passed Proposition 13 in 1978, which fundamentally restricted the ability of local governments to raise funds to finance schools through local property tax revenues."[6] Proposition 13, most significantly, limited the tax rates applicable to real property, and limited the rate of increase of the underlying assessed value; it also provided that future changes to state taxes must be passed by two-thirds of the Legislature, and future changes to local taxes must be enacted by two-thirds of the electorate. These changes significantly hampered the ability of local governments to raise revenue when necessary, and gave rise to a number of further changes to assist the local governments in providing services, while protecting revenues, including article XIII B, section 6, enacted as Proposition 4 (1980).[7]

The ERAF Shifts

School and local government funding remained stable enough, with help from the state, until the state "faced an unprecedented budgetary crisis at the outset of fiscal year 1991-1992, with expenditures projected to exceed revenues by more than $14 billion."[8] The Legislature answered this crisis by directing counties to create an ERAF, into which county auditors were directed to pour a percentage of property tax revenues previously allocated to cities, counties, redevelopment agencies, and special districts. The property tax revenues in the ERAF were then to be distributed to schools and community colleges, reducing the state's share of Proposition 98 minimum guarantee funding beginning in fiscal year 1992-1993.[9] A second ERAF shift was ordered in 1993,[10] and concurrently "the state cushioned the loss of revenue to local

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[3] *Id*, at p. 589.

[4] *Serrano v. Priest* (*Serrano II*) (1976) 18 Cal.3d 728.

[5] *County of Sonoma v. Commission on State Mandates* (*Sonoma*) (Cal. Ct. App. 1st Dist. 2000) 84 Cal.App.4th 1264, at p. 1272.

[6] *Id*, at p. 1273.

[7] *Id*, at pp. 1273-1274.

[8] *Sonoma*, *supra*, at p. 1274.

[9] Exhibit X, LAO Report, Insufficient ERAF, at p. 4.

[10] *City of El Monte v. Commission on State Mandates* (Cal. Ct. App. 3d Dist. 2000) 83 Cal.App.4th 266, at p. 274.

governments through a variety of mitigation measures, including an additional sales tax…trial court funding reform, supplemental funding for special police protection districts, grants of authority to counties to reduce general assistance levels, loans for property tax administration and a one-time mitigation of $292 million."[11]

The redirecting of property taxes into the ERAF was upheld against constitutional challenge, with the court of appeal noting that the "entire law-making authority of the state, except the people's right of initiative and referendum, is vested in the Legislature, and that body may exercise any and all legislative powers which are not expressly, or by necessary implication denied to it by the Constitution." The court held that the principle "is of particular importance in the field of taxation," and that "the Legislature's authority to impose taxes and regulate the collection thereof exists unless it has been *expressly* eliminated by the Constitution."[12] The court noted "a historical fluidity in the fiscal relationship between local governments and schools," and found nothing in the Constitution to restrict the Legislature's ability to engage in "comprehensive legislative planning for the funding of both entities from a variety of sources, including property tax revenue."[13]

In addition to being upheld against constitutional challenge, the amount shifted by the ERAF legislation, and thus suffered by local government, was also held not reimbursable under article XIII B, section 6.[14] Forty-eight counties, including the County of Sonoma, which would become the plaintiff in the superior court action, brought a test claim before the Commission seeking reimbursement for the revenue lost by the ERAF shift. The claimants contended that article XIII B, section 6 required the state to reimburse the local governments for the portion of their property tax revenues that had been taken and shifted to schools through the creation and funding of the ERAFs in each county, pursuant to Statutes 1992, chapters 699 and 700 (SB 844). The Commission denied the claim, concluding that "although the test claim reduced county revenues, it did not impose a spending program."[15] The trial court disagreed, but the court of appeal for the first district upheld the Commission's decision, finding that *actual increased costs* must be demonstrated, not merely *decreases in revenue*.[16] The court distinguished the case from *Lucia Mar*, and *County of San Diego*, on the ground that in both of those cases the state had previously been solely responsible for the costs of the program in question, while school funding, the

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[11] *Sonoma, supra*, at p. 1276.

[12] *County of Los Angeles v. Sasaki* (Cal. Ct. App. 2d. Dist. 1994) 23 Cal.App.4th 1442, at pp. 1453-1454 [internal citations omitted]. See also *San Miguel Consolidated Fire Protection District v. Davis* (Cal. Ct. App. 3d Dist. 1994) 25 Cal.App.4th 134 [article XIII A, section 1, does not limit the ability of the Legislature to apportion property tax revenues].

[13] *Sasaki, supra*, at p. 1457.

[14] *Sonoma, supra*, at pp. 1277-1289.

[15] *Sonoma, supra*, at p. 1277.

[16] *Id*, at p. 1285.

subject of the *Sonoma* action, had been a shared endeavor of the state and local governments, "subject to changing allocations of responsibility."[17]

In accord is *City of El Monte, supra,* in which ERAF losses incurred by redevelopment agencies were held not reimbursable, either to the city itself, or to the agency. In that case the court relied in part on *City of San Jose*,[18] finding that "the shift of a portion of redevelopment agency funds to local schools did not create a reimbursable state mandate," because the shift was from one local entity to another. The court also held, alternatively, that because the shifted funds were permitted, pursuant to the statute, to be paid from *any legally available source,* including tax increment financing, the legislation did not impose costs that could be recovered solely from *proceeds of taxes,* within the meaning of article XIII B, section 6. Tax increment financing, specifically, "the most important method of financing employed by a redevelopment agency,"[19] had already been established as a funding source other than "proceeds of taxes."[20] Accordingly, "under the reasoning of *County of Fresno v. State of California*, 53 Cal.3d at pp. 486-487, the ERAF legislation did not impose a reimbursable state mandate."

However, the administrative activities conducted under the prior ERAF statutes, and the costs incurred by counties to shift and transfer funds, *were found to be reimbursable,* in a separate test claim. In its statement of decision on *Allocation of Property Tax Revenues* (CSM-4448), the Commission found that "the provisions of Revenue and Taxation Code sections 97, 99.01, 97.02, 97.03, 97.035, 97.5, 98, and 99, as added or amended as specified herein, do impose a new program or higher level of service…by requiring counties to redesign the terms, conditions, rules, and formulas for reallocating California's local property tax revenues." In that test claim, the Commission found reimbursable only "that portion of the new and additional accounting procedures that apply to school districts because counties are specifically forbidden from charging school districts for the administrative costs of allocating property taxes as specified and from recovering any lost school administrative fees by charging other types of jurisdictions."[21]

The current ERAF shift is limited to the 2004-2005 and 2005-2006 fiscal years, and impacts cities, counties, redevelopment agencies, special districts, and joint county special districts, requiring these entities to transfer a portion of revenues otherwise received to the ERAF. This shift relieves, temporarily, the state's burden in meeting its obligation to fund education at a minimum level. However, as discussed below, the ERAF moneys are also called upon to replace the VLF backfill payments and the sales and use tax revenue losses due to dedicating those funds to the repayment of economic recovery bonds authorized in Proposition 57.

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[17] *Id*, at p. 1287 [distinguishing from *Lucia Mar Unified School District v. Honig* (1988) 44 Cal.3d 830; *County of San Diego v. State of California* (1997) 15 Cal.4th 68].

[18] (1996) 45 Cal.App.4th 1802.

[19] *City of El Monte*, *supra*, 83 Cal.App.4th at p. 269.

[20] See *Brown v. Community Redevelopment Agency* (1985) 168 Cal.App.3d 1014; *Bell Community Redevelopment Agency v. Woosley* (1985) 169 Cal.App.3d 24.

[21] Test Claim Statement of Decision, *Allocation of Property Tax Revenues*, dated October 18, 1994 (CSM-4448), at pp. 18-19.

The VLF Swap

The Vehicle License Fee (VLF) has been, since its inception in 1935, primarily and traditionally a local government revenue resource.[22] The fee is based on the purchase price of the vehicle, and indexed to decline as the vehicle depreciates. Beginning in the late 1990's the Legislature reduced the VLF rates, formerly set at two percent of the price of the vehicle, depreciating year over year; and "back-filled" the lost revenue to counties and cities from General Fund allocations.[23] A trigger provision was included to *increase* the VLF when General Fund revenues were determined to be insufficient to backfill the losses, which then-Governor Davis instituted in 2003, shortly before losing office in the November 2003 recall election. After assuming office, then-Governor Schwarzenegger reversed the determination of insufficiency, and reinstated the back-fill payments and the lower VLF rates. Then in 2004, a new mechanism for reimbursing the reduced VLF revenue to local governments was developed, which was meant to provide "an element of increased security," but also to save the state a substantial amount of money:

> Specifically, the VLF Swap replaced the General Fund VLF backfill with property taxes redirected at the county level from (1) ERAF and, if ERAF revenues are not sufficient, from (2) nonbasic aid K-12 and community college districts. (All reductions in revenue to K-12 and community college districts are offset by additional state aid.)[24]

The VLF Swap also provided that future growth in reimbursements would follow growth in property values within the community, by tying the annual calculation of the adjustment amount to the percentage change in gross taxable assessed valuation in the jurisdiction.

Triple Flip

The test claim statute, Statutes 2003, chapter 162 (AB 1766), created the Triple Flip as a means to provide a steady and dedicated funding stream to repay deficit financing bonds approved by the Legislature in Statutes 2003-2004, 1st Extraordinary Session, chapter 13 (AB 1X7).[25,26] The legislatively-authorized bonds were challenged in the courts, and never issued.[27] Then in December 2003, the Legislature repealed and reenacted the Triple Flip,[28] in a bill made

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[22] Exhibit X, LAO Report: Insufficient ERAF, at p. 5.

[23] Exhibit X, LAO Report: Insufficient ERAF, at p. 5. See Also Statutes 1998, chapter 322 (AB 2797.

[24] *Id*, at p. 6.

[25] Statutes 2003-2004, 1st Extraordinary Session, chapter 13 (AB 1X7) was not pled in this test claim, but does not appear to impose any activities or tasks upon local government.

[26] Both Statutes 2003, chapter 162 (AB 1766) and Statutes 2003-2004, 1st Extraordinary Session, chapter 13 (AB 1X7) were enacted on August 2, 2003.

[27] Exhibit X, Voter Information Guide, Supplemental, March 2, 2004, at p. 7.

[28] The repeal and reenactment of the Triple Flip had no effect on the underlying law with respect to mandates. See California Jurisprudence, 3d, Statutes, section 78 ["[I]f a new statute repeals an existing statute and they both legislate upon the same subject, and in many cases, the provisions of the two statutes are similar, and almost identical, and there never has been a moment of time

contingent upon voter approval of economic recovery bonds, to be placed on the March 2, 2004 ballot.[29]

Then, in 2004, the voters approved Proposition 57, which created "a deficit-financing bond to address the state's budget shortfall." The LAO describes the triple flip as follows:

- 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.
- K-12 and community college district tax losses from the redirection of ERAF to cities and counties, in turn, are offset by increased state aid.

The LAO projects that triple flip will end (i.e., the bonds will be repaid) by 2016-2017, and "the $1.7 billion in ERAF monies that otherwise would have been used to fund the triple flip will be available for other uses—namely funding the VLF Swap and offsetting state K-14 expenditures."[30]

III. Positions of the Parties

Claimant's Position

The claimant seeks reimbursement for the "close and daily collaboration of State and local revenue management officials" necessary to implement the "innovative revenue systems" that the state put in place in the test claim statutes.

The claimant alleges that the state saved $1.3 billion in 2004-2005 and 2005-2006 by shifting and redirecting funds from the three sources, as discussed above. The claimant states:

> Of course, reimbursement for the $1.3 billion the State saved in reducing local governments' property tax revenues is not sought here. What is sought here is reimbursement for the increased costs which the County of Los Angeles and other counties throughout the State have incurred during 2004-05 [$13,301,018] and

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since the passage of the existing statute when these similar provisions have not been in force, the new act should be construed as a continuation of the old with the modification contained in the new act."] See also *In re Dapper*, 71 Cal.2d 184, at p. 189, citing *Sobey v. Molony*, 40 Cal.App.2d, 381, at p. 385 ["When a statute, although new in form, re-enacts an older statute without substantial change, even though it repeals the older statute, the new statute is but a continuation of the old. There is no break in the continuous operation of the old statute, and no abatement of any of the legal consequences of acts done under the old statute."]

[29] Statutes 2003-2004, 5th Extraordinary Session, chapter 2 (AB 5X9) was also not pled in this test claim, but added to section 97.68 only subdivision (g), the text of which had been in the uncodified section of Statutes 2003, chapter 162, and which does not impose any activities or tasks upon local government.

[30] Exhibit X, LAO Report: Insufficient ERAF, at pp. 4-5.

> will incur during 2005-06 [$12,580,829] as an unavoidable consequence of complying with this test claim legislation.
>
> The costs claimed herein meet the requirements for reimbursable costs under Section 6 of Article XIIIB of the California Constitution. First, increased costs were incurred after July 1, 1980. Secondly, such costs were incurred as a result of statutes enacted on or after January 1, 1975. And, third, increased costs were incurred to implement a new program or a higher level of service of an existing program.[31]

The claimant also asserts that sections 17556(d), 17556(e), and 17556(f) do not apply to bar reimbursement. The claimant asserts that section 17556(d) is not applicable because charging fees or levies against cities is expressly prohibited by the test claim statutes (albeit only for the 2004-2005 and 2005-2006 fiscal years), and that therefore "the County has no authority to levy services charges, fees, or other assessments under the test claim legislation or under other authority."[32] The claimant asserts that section 17556(e) does not bar reimbursement because "[n]o offsetting savings to local agencies or school districts were provided," and because "no revenue that was specifically intended to fund the costs of the State mandates claimed herein was provided." Finally, the claimant asserts that section 17556(f) is not applicable to bar reimbursement because, in the claimant's view, the test claim statutes are not necessary to implement or reasonably within the scope of any voter-enacted ballot initiatives. The claimant cites Propositions 57 (March 2004), 1A, and 65 (November 2004), but argues that none implicate section 17556(f).[33]

The claimant alleges also that it determined the costs of the test claim statutes, with the participation of twenty-four counties:

> In order to develop and implement a compliant ancillary tax revenue allocation system, counties performed planning, implementation, State reporting, distribution and administrative duties not required under prior law. The costs of performing these duties were studied by twenty-four· counties and are reported herein under the Cost Study section.

The claimant asserts that the planning activities include interpretation of the test claim statutes, and meeting and conferring with state officials to develop guidelines and a model for the shifts. The implementation activities alleged include establishing new accounts for the reallocated funds, reviewing the reduction amounts received from DOF, and "[i]nclusion of the ERAF III shift in the calculation of the County Property Tax Administrative Cost (SB2557)." The claimant also asserts that "[t]he County prepares voluminous, periodic, special State reports, required by the State Controller's Office to monitor compliance with the subject laws." Finally, the claimant also asserts that "County Auditor-Controller personnel were called upon to explain the new property tax revenue allocations under the subject laws," and that "considerable staff

[31] Exhibit A, Test Claim, at p. 11.

[32] Exhibit A, Test Claim, at p. 124.

[33] Exhibit A, Test Claim, at p. 126.

time was involved in answering questions from the County's local taxing jurisdictions regarding their specific allocation(s)."[34]

The claimant therefore has submitted a cost study, based on a survey of county staff, and including legislation analysis and other planning activities, as well as reviewing the amounts given by DOF, and other implementation activities, and administering the shifts.[35]

The claimant submitted comments on the draft staff analysis on July 19, 2013, concurring with the draft staff analysis, and the conclusion that the test claim legislation imposes reimbursable mandated activities on counties.[36]

State Agencies' Position(s)

The Department of Finance submitted comments on the draft staff analysis on July 10, 2013, in which DOF concurred with staff's conclusion that the test claim statutes impose a partially reimbursable state-mandated program.[37]

IV. Discussion

Article XIII B, section 6 of the California Constitution provides in relevant part the following:

> Whenever the Legislature or any state agency mandates a new program or higher level of service on any local government, the state shall provide a subvention of funds to reimburse such local government for the costs of such programs or increased level of service, except that the Legislature *may, but need not*, provide a subvention of funds for the following mandates:
>
> (1) Legislative mandates requested by the local agency affected.
>
> (2) Legislation defining a new crime or changing an existing definition of a crime.
>
> (3) Legislative mandates enacted prior to January 1, 1975, or executive orders or regulations initially implementing legislation enacted prior to January 1, 1975.

The purpose of article XIII B, section 6 is to "preclude the state from shifting financial responsibility for carrying out governmental functions to local agencies, which are 'ill equipped' to assume increased financial responsibilities because of the taxing and spending limitations that articles XIII A and XIII B impose."[38] Thus, the subvention requirement of section 6 is "directed to state-mandated increases in the services provided by [local government] …"[39]

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[34] Exhibit A, Test Claim, at pp. 90-98.

[35] Exhibit A, Test Claim, at p. 98 and following.

[36] Exhibit I, Claimant Comments on Draft Staff Analysis.

[37] Exhibit H, DOF Comments on Draft Staff Analysis.

[38] *County of San Diego v. State of California* (1997) 15 Cal.4th 68, 81.

[39] *County of Los Angeles v. State of California* (1987) 43 Cal.3d 46, 56.

Reimbursement under article XIII B, section 6 is required when the following elements are met:

1. A state statute or executive order requires or "mandates" local agencies or school districts to perform an activity.[40]
2. The mandated activity either:
    a. Carries out the governmental function of providing a service to the public; or
    b. Imposes unique requirements on local agencies or school districts and does not apply generally to all residents and entities in the state.[41]
3. The mandated activity is new when compared with the legal requirements in effect immediately before the enactment of the test claim statute or executive order and it increases the level of service provided to the public.[42]
4. The mandated activity results in the local agency or school district incurring increased costs, within the meaning of section 17514. Increased costs, however, are not reimbursable if an exception identified in Government Code section 17556 applies to the activity.[43]

The determination whether a statute or executive order imposes a reimbursable state-mandated program is a question of law.[44] The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.[45] In making its decisions, the Commission must strictly construe article XIII B, section 6, and not apply it as an "equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities."[46]

A. Some of the test claim statutes impose a mandated new program or higher level of service upon counties.

As noted above, the claimant seeks reimbursement for, in the words of the LAO, "the complex process county auditors follow to allocate ERAF and to reimburse cities and counties for the triple flip and VLF Swap."[47] The following analysis will demonstrate that the operations required by the test claim statutes are indeed "complex," and that the claimant has alleged

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[40] *San Diego Unified School Dist. v. Commission on State Mandates* (*San Diego Unified School Dist*.) (2004) 33 Cal.4th 859, 874.

[41] *Id*. at 874-875 (reaffirming the test set out in *County of Los Angeles*, *supra*, 43 Cal.3d 46, 56.)

[42] *San Diego Unified School Dist.*, *supra*, 33 Cal.4th 859, 874-875, 878; *Lucia Mar Unified School District v. Honig* (1988) 44 Cal.3d 830, 835.

[43] *County of Fresno v. State of California* (1991) 53 Cal.3d 482, 487; *County of Sonoma v. Commission on State Mandates* (Cal. Ct. App. 1st Dist. 2000) 84 Cal.App.4th 1265, 1284; Government Code sections 17514 and 17556.

[44] *County of San Diego*, *supra*, 15 Cal.4th 68, 109.

[45] *Kinlaw v. State of California* (1991) 53 Cal.3d 482, 487.

[46] *County of Sonoma*, *supra*, 84 Cal.App.4th 1265, 1280 [citing *City of San Jose*, *supra*].

[47] Exhibit X, LAO Report: Insufficient ERAF, at p. 7.

increased costs as a result of these accounting processes not previously required. The Commission therefore finds that the test claim statutes impose a state-mandated new program or higher level of service upon counties.

1. Property Taxes/ERAF III Shift

Revenue and Taxation Code sections 97.71, 97.72, and 97.73, as added by Statutes 2004, chapter 211 (SB 1096), and amended by Statutes 2004, chapter 610 (AB 2115), provide for shifting funds from cities, counties, cities and counties, and special districts, to a county's ERAF, for the 2004-2005 and 2005-2006 fiscal years. Likewise, Health and Safety Code sections 33681.12, added by Statutes 2004, chapter 211 (SB 1096); 33681.13 and 33681.14, added by Statutes 2004, chapter 211 (SB 1096) and amended by Statutes 2004 chapter 610 (AB 2115); and 33681.15, added by Statutes 2004, chapter 610 (AB 2115), provide for shifting funds from redevelopment agencies to a county's ERAF for the 2004-2005 and 2005-2006 fiscal years. The claimant alleges that these sections impose state-mandated requirements upon counties to reduce, as directed by the statutes, and in amounts identified by the Controller, revenues otherwise allocated to local entities, including cities, counties, special districts, and redevelopment agencies, and to deposit those moneys in the ERAF.

The claimant also alleges reimbursable activities under sections 97.31, as amended by Statutes 2004, chapter 211 (SB 1096); 97.77, as added by Statutes 2004, chapter 211 (SB 1096); and 98.02, as amended by Statutes 2004, chapter 211 (SB 1096), as discussed below.[48]

a. Revenue and Taxation Code section 97.71 (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats. 2004, ch. 610 (AB 2115)).

Section 97.71 defines the method of calculating the ERAF III shift amount for each city, county, and city and county. The claimant concedes that "[t]he State Controller is responsible for making these calculations and notifies each County Auditor-Controller of the amounts to shift."[49] Therefore, from the outset it is clear that only the reduction and transfer of funds, and *not the calculation of the amounts* to reduce and transfer, constitute the mandated activities required by the plain language of the statute.

Section 97.71(a) provides dollar-amount reductions for each county, from the total revenue required to be allocated under section 97.70, to take place in the 2004-2005 and 2005-2006 fiscal years only.[50] For a city and county (i.e., the city and county of San Francisco), paragraph (b)(1) provides for an additional reduction of total revenue allocated under section 97.70 based on the fraction created by the amount of money *allocated to the city and county* from the Motor Vehicle License Fee Account for the 2002-2003 fiscal year, divided by the amount of money *allocated among all cities and cities and counties* from the Motor Vehicle License Fee Account for the 2002-2003 fiscal year (which yields a fraction representing the city and county of San Francisco's portion of total statewide revenues from the Motor Vehicle License Fee Account); multiplied by the intended total reduction for all counties and cities and counties of $350 million.

[48] Exhibit A, Test Claim, at pp. 73-82.

[49] Exhibit A, Test Claim, at p. 54.

[50] Revenue and Taxation Code section 97.71(a) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

For all other cities, the reduction in total revenue is allocated among the cities based on each city's share of Motor Vehicle License Fee revenues, sales and use tax revenues, and ad valorem property tax revenues, compared to those three revenue sources for all cities. The calculation required is as follows:

The first reduction factor is the revenue received by *each* city under the Transportation Tax Fund for 2002-2003, divided by the revenue received by *all* cities from the Transportation Tax Fund for 2002-2003, multiplied by thirty three and one-third percent, multiplied by $350 million less the amount determined for the city and county of San Francisco in paragraph (b)(1).

The second reduction factor is the revenue received by contract with the State Board of Equalization from sales and use taxes by *each* city, divided by the revenue received from sales and use taxes by *all* cities, multiplied by thirty three and one-third percent, multiplied by $350 million less the amount determined for the city and county in paragraph (b)(1).

The third reduction factor is the revenue received from ad valorem property taxes by *each* city, divided by the ad valorem property taxes received by *all* cities, multiplied by multiplied by thirty three and one-third percent, multiplied by $350 million less the amount determined for the city and county in paragraph (b)(1).[51]

The total reduction calculated for any city "shall not be less than 2 percent, nor more than 4 percent, of the general revenues of the city, as reported in the 2001-02 edition of the State Controller's Cities Annual Report." If the amount determined exceeds 4 percent of a city's general revenues, the amount of the excess shall be allocated to other cities in proportionate shares.[52]

The section provides that a city may, in lieu of reduction of revenues, "transmit to the county auditor for deposit in the county Educational Revenue Augmentation Fund an amount equal to that reduction."[53]

These calculations are, in the words of the LAO, "complex." And the operations required are alleged to result in substantial time and expense being incurred by county auditors, as discussed below. However, as noted in the test claim, the "State Controller is responsible for making these calculations and notifies each County Auditor-Controller of the amounts to shift."[54] Performing the necessary calculations is therefore not a mandated activity; only reducing the revenues as directed is mandated.

Once the reductions are made, as directed, the section requires that the amount of revenue "that is not allocated to a county, city and county, or a city as a result of subdivisions (a) and (b), and that amount that is received by the county auditor under paragraph (5) of subdivision (b) (an

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[51] Revenue and Taxation Code section 97.71(b)(2) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[52] Revenue and Taxation Code section 97.71(b)(4) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[53] Revenue and Taxation Code section 97.71(b)(5) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[54] Exhibit A, Test Claim Filing, at p. 54. See also Revenue and Taxation Code section 97.71(b)(3) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

equal amount in lieu of the reduction), shall be deposited in the county Educational Revenue Augmentation Fund and shall be allocated as specified in subdivision (d) of Section 97.3."[55] Section 97.3 is not amended by the test claim statutes, nor pled in this test claim, and therefore the Commission does not here consider whether section 97.3, addressing the allocation of funds, imposes reimbursable state-mandated activities upon the counties.

The activities required of county auditors to reduce revenue as directed and deposit money in the county's ERAF are mandatory, based on the plain language of the statute. The activities are also new, and are required in addition to the ERAF shifts established in the 1990's, as discussed above. The additional, and temporary, ERAF shifts required for fiscal years 2004-2005 and 2005-2006 were not required under prior law. Finally, the activities required fall uniquely upon local government.[56] Therefore the activities to reduce revenue as directed and deposit money in the county's ERAF impose a mandated new program or higher level of service upon counties, within the meaning of article XIII B, section 6.

The Commission finds that section 97.71 as added by Statutes 2004, chapter 211 (SB 1096), and amended by Statutes 2004, chapter 610 (AB 2115), imposes a mandated new program or higher level of service upon the counties to perform the following activities during fiscal years 2004-2005 and 2005-2006 only:

- Reduce revenue otherwise required to be allocated to each county, for the 2004-2005 and 2005-2006 fiscal years only, by the amounts listed in Revenue and Taxation Code section 97.71(a)(1), and deposit that amount in the county's ERAF.[57]
- Reduce revenue otherwise required to be allocated to a city and county, for the 2004-2005 and 2005-2006 fiscal years only, by an amount identified by the Controller pursuant to Revenue and Taxation Code section 97.71 (b)(2-3), and deposit that amount in the county's ERAF.[58]
- Reduce revenue otherwise required to be allocated to each city within the county, for the 2004-2005 and 2005-2006 fiscal years only, by an amount identified by the Controller pursuant to Revenue and Taxation Code section 97.71(b)(2-3), and deposit that amount in the county's ERAF.[59]

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[55] Revenue and Taxation Code section 97.71(c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[56] Revenue and Taxation Code section 97.71(b)(3) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[57] Revenue and Taxation Code section 97.71(a)(1); (c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[58] Revenue and Taxation Code section 97.71(b); (c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[59] Revenue and Taxation Code section 97.71(c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

- Where applicable, accept from a city, in lieu of reduction of that city's revenues, an amount equal to the required reduction, and deposit those moneys in the county's ERAF.[60]

Reimbursement is not required for calculating the amounts of revenue otherwise required to be allocated to a city, county, or city and county, which must be reduced and deposited in the county ERAF.[61]

b. Revenue and Taxation Code sections 97.72, 97.73, and 97.77 (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats. 2004, ch. 610 (AB 2115))

Sections 97.72 and 97.73, as added by Statutes 2004, chapter 211 (SB 1096), and amended by Statutes 2004, chapter 610 (SB 2115), provide for reductions of ad valorem property tax revenue otherwise required to be allocated to special districts, and require the county to reduce the revenue, as directed, and deposit the reduced amounts in the county's ERAF. Sections 97.72 and 97.73, in the claimant's words, "define the method of calculating the ERAF III shift amount for each special district," but again the claimant notes that the County Auditor-Controller will be notified of the amounts to shift.[62] The claimant alleges that counties have incurred increased costs due to implementation of the ERAF III shift, requiring "the close collaboration of State as well as local officials."[63]

Section 97.72 describes the amount of ad valorem property tax revenue to be shifted from each enterprise special district to the county's ERAF, on the basis of amounts determined by the Controller, and passed along to the county auditor by way of the Director of Finance.[64] For a special district located in more than one county, the county auditor must prorate the total shift amount among the affected counties based on the ad valorem property taxes allocated to the district from *each* county.[65] Section 97.72 provides that the amount of ad valorem property tax revenue "that is not allocated to an enterprise special district as a result of subdivision (a) shall

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[60] Revenue and Taxation Code section 97.71(b)(5) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[61] Revenue and Taxation Code section 97.71(b)(3) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[62] Exhibit A, Test Claim, at p. 58.

[63] Exhibit A, Test Claim, at p. 66.

[64] Revenue and Taxation Code section 97.72(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[65] Exhibit A, Test Claim Filing, at pp. 58; Revenue and Taxation Code section 97.72 (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)) Although the section states that for multi-county special districts a county auditor "shall implement that portion of the total reduction," pursuant to paragraph (a)(1), the Controller is still required to determine the amount of revenue reductions required for each special district "required by paragraph (1)," pursuant to paragraph (a)(2).

instead be deposited in the county Educational Revenue Augmentation Fund and shall be allocated as specified in Section 97.3."[66,67]

Section 97.73 describes the amount of ad valorem property tax revenue to be shifted from each nonenterprise special district to the county's ERAF, on the basis of amounts determined by the Controller. If a special district is located in more than one county, the auditor of each county "shall implement that portion of the total reduction, required by subparagraph (A) with respect to that district, determined by the ratio of the amount of ad valorem property tax revenue allocated to that district from the county to the total amount of ad valorem property tax revenue allocated to that district from all counties."[68] And, like section 97.72, the statute provides that the amounts not allocated to a nonenterprise special district "shall instead be deposited in the county Educational Revenue Augmentation Fund and shall be allocated as specified in subdivision (d) of section 97.3."[69, 70]

The activities required of county auditors are mandatory, based on the plain language of the statute. Auditors are required to make the reductions based on the amounts determined by the Controller and conveyed to the auditor, and deposit the reduced amounts in the county's ERAF in each of the 2004-2005 and 2005-2006 fiscal years. The activities are also new; the ERAF program was created in 1992, and amended in 1993, but the additional ERAF shifts required for fiscal years 2004-2005 and 2005-2006 were not required under prior law.[71] Finally, the activities required fall uniquely upon local government.[72] Therefore the activities of reducing the revenue as directed and depositing money in the county's ERAF impose a mandated new program or higher level of service upon counties, within the meaning of article XIII B, section 6.

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[66] Revenue and Taxation Code section 97.72(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[67] As noted above, Section 97.3 is not amended by the test claim statutes, nor pled in this test claim, and therefore the Commission does not here consider whether section 97.3 imposes reimbursable state-mandated activities upon the counties.

[68] Revenue and Taxation Code section 97.73(a)(1)(C) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)). As with section 97.72, above, although the section states that for multi-county special districts a county auditor "shall implement that portion of the total reduction," the Controller is still required to determine the amount of revenue reductions required for each special district "required by paragraph (1)," pursuant to paragraph (a)(2).

[69] Revenue and Taxation Code section 97.73(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[70] As noted above, Section 97.3 is not amended by the test claim statutes, nor pled in this test claim, and therefore the Commission does not here consider whether section 97.3 imposes reimbursable state-mandated activities upon the counties.

[71] See *City of Alhambra v. County of Los Angeles* (2012) 55 Cal.4th 707, at p. 714 [discussing the "permanent base shifts required by ERAF I and ERAF II"].

[72] Revenue and Taxation Code section 97.72(a)(2); 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

Section 97.77 provides that special districts, both enterprise and nonenterprise, *shall not pledge*, on or after July 1, 2004, and before June 30, 2006, through a bond covenant to pay debt service costs on debt instruments issued by the district, any ad valorem property tax revenue that would otherwise be dedicated to the reduction required by Sections 97.72 and 97.73. This section is prohibitive, not mandatory, and does not impose any mandated activities upon local government.

Sections 97.72 and 97.73, as added by Statutes 2004, chapter 211 (SB 1096), and amended by Statutes 2004, chapter 610 (AB 2115), impose a mandated new program or higher level of service for each county to perform the following activities during fiscal years 2004-2005 and 2005-2006 only:

- Reduce, during fiscal years 2004-2005 and 2005-2006, the amount of ad valorem property tax otherwise required to be allocated to an enterprise special district, including an enterprise special district located in more than one county, in amounts determined by the Controller and received from the Director of Finance, for each enterprise special district in the county.[73]
- Deposit the amounts reduced in fiscal years 2004-2005 and 2005-2006 from each enterprise special district in the county's ERAF.[74]
- Reduce, during fiscal years 2004-2005 and 2005-2006, the amount of ad valorem property tax otherwise required to be allocated to a nonenterprise special district, including a nonenterprise special district located in more than one county, in amounts determined by the Controller for each special district in each county.[75]
- Deposit the amounts reduced in fiscal years 2004-2005 and 2005-2006 from each nonenterprise special district in the county's ERAF.[76]

Reimbursement is not required for calculating the amounts of ad valorem property tax otherwise required to be allocated to an enterprise or nonenterprise special district which must be reduced and deposited in the county ERAF.[77]

c. Health and Safety Code sections 33681.12, 33681.13, 33681.14, and 33681.15 (as added or amended by Statutes 2004, chapter 211 (SB 1096) and Statutes 2004, chapter 610 (AB 2115))

[73] Revenue and Taxation Code section 97.72(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[74] Revenue and Taxation Code section 97.72(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[75] Revenue and Taxation Code section 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[76] Revenue and Taxation Code section 97.73(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[77] Revenue and Taxation Code sections 97.72(a)(2); 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

Section 33681.12 provides that a redevelopment agency shall, for the 2004-2005 and 2005-2006 fiscal years, prior to May 10, "remit an amount equal to the amount determined for that agency … to the county auditor for deposit in the county's Educational Revenue Augmentation Fund." The county auditor, in turn, must receive the funds from the redevelopment agency and deposit those funds in the county's ERAF. Paragraph (a)(2) describes how the Director of Finance determines the amount for each agency, and subparagraphs (a)(2)(J) and (K) require the Director to notify each agency and each legislative body, and each county auditor, of the amounts determined.[78] A redevelopment agency may use any funds that are legally available and not obligated for other use in order to make the allocation required. The "legislative body," defined as "the city council, board of supervisors, or other legislative body of the community,"[79] "shall by March 1 report to the county auditor as to how the agency intends to fund the allocation required by this section."[80] The county auditor, in turn, must receive that information from the legislative body, based on the plain language of the statute.

Section 33681.13 provides that a redevelopment agency may allocate less than the amount required under section 33681.12, if necessary to service existing indebtedness. The redevelopment agency must adopt a resolution prior to December 31 of the fiscal year, identifying each existing indebtedness and the amounts owed. A redevelopment agency is required, if constrained by existing indebtedness and thereby unable to remit the amount required under section 33681.12, to enter into an agreement with the legislative body of the county or city where the redevelopment agency is located by February 15 of the applicable fiscal year to fund the payment of the difference between the amount required under section 33681.12 and the amount available for allocation by the agency. If the agency fails to transmit the full amount required by section 33681.12, is precluded by court order from transmitting that amount, or is otherwise unable to meet its full obligation, the county auditor, "by no later than May 15 of the applicable fiscal year, shall transfer any amount necessary to meet the obligation determined for that agency…from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95)…of the Revenue and Taxation Code."[81]

Section 33681.14 provides that a legislative body may, in lieu of the remittance required by section 33681.12 "prior to May 10 of the applicable fiscal year, remit an amount equal to the amount determined for the agency…to the county auditor for deposit in the county's Educational Revenue Augmentation Fund." If the legislative body reported to the county auditor that it intended to remit the amount on behalf of the redevelopment agency and the legislative body fails to transmit the full amount by May 10, "the county auditor, no later than May 15 of the applicable fiscal year, shall transfer an amount necessary to meet the obligation from the legislative body's allocations pursuant to Chapter 6 (commencing with section 95)…of the Revenue and Taxation Code." If the amount of the legislative body's allocations are not sufficient to meet the obligation under section 33681.12, "the county auditor shall transfer an

[78] Health and Safety Code section 33681.12(a) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[79] Health and Safety Code section 33007 (Stats. 1963, ch. 1812).

[80] Health and Safety Code section 33681.12(d) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[81] Health and Safety Code section 33681.13 (added by Stats. 2004, ch. 211 (SB 1096)).

additional amount necessary to meet this obligation from the property tax increment revenue apportioned to the agency pursuant to Section 33670, provided that no moneys allocated to the agency's Low and Moderate Income Housing Fund shall be used for this purpose."[82]

Section 33681.15 provides that a redevelopment agency may enter into an agreement with an authorized bond issuer, as defined, to obtain a loan from the issuer in order to make the payment required by section 33681.12. If the redevelopment agency fails to repay the loan in accordance with the schedule provided to the county auditor, the trustee for the bonds shall promptly notify the county auditor of the amount that is past due.[83] The county auditor shall reallocate from the county or city legislative body and shall pay, on behalf of the redevelopment agency, the past due amount from the first available proceeds of the property tax allocation that would otherwise be transferred to the legislative body.[84] While all other activities of sections 33681.12-33681.14, by their terms, would occur within fiscal years 2004-2005 or 2005-2006, the failure of a redevelopment agency to make timely payments on its loan from an authorized bond issuer could occur at some later time. If and when that failure occurs, it triggers the requirement of the county auditor to extract the funds from allocations otherwise required to be made to the county or city with which the redevelopment agency is associated. Therefore, this activity is not limited to the 2004-2005 and 2005-2006 fiscal years, as are all other ERAF III shift activities discussed in the above analysis.

As discussed in *City of El Monte v. Commission on State Mandates* (Cal. Ct. App. 3d Dist. 2000) 83 Cal.App.4th 266, a redevelopment agency is not an eligible claimant before the Commission.[85] However, there are mandated activities found in the plain language of the test claim statute, as noted above, imposed upon counties. Those activities that are imposed upon the counties constitute mandated new programs or higher levels of service. The activities are new, with respect to prior law, and the activities fall uniquely upon local government.

The Commission finds that Health and Safety Code sections 33681.12, 33681.13, 33681.14, and 33681.15, as added or amended by Statutes 2004, chapter 211 (SB 1096), or Statutes 2004, chapter 610 (AB 2115), mandate a new program or higher level of service on counties as specified below:

> <u>For the county auditor to perform the following activities for 2004-2005 and 2005-2006 fiscal years only:</u>
>
> - Receive funds directly from a redevelopment agency in the amount identified by the Director of Finance, and deposit those funds in the county's ERAF.[86]

[82] Health and Safety Code section 33681.14 (added by Stats. 2004, ch. 211 (SB 1096)).

[83] Health and Safety Code section 33681.15(f) (added by Stats 2004, ch. 610 (AB 2115)).

[84] Health and Safety Code section 33681.15(g) (added by Stats 2004, ch. 610 (AB 2115)).

[85] See also, *Bell Community Redevelopment Agency v. Woosley*, (1985) 169 Cal.App.3d 24, at pp. 33-34; *Brown v. Community Redevelopment Agency*, (1985) 168 Cal.App.3d 1014 at p. 1020.

[86] Health and Safety Code section 33681.12(a) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

- Receive from the legislative body of the relevant city or county associated with a redevelopment agency, by March 1 of the applicable fiscal year, a report as to how the redevelopment agency intends to secure the funds required to be transferred to the county.[87]

- If a redevelopment agency fails to transmit the full amount of funds required by Section 33681.12, is precluded by court order from transmitting that amount, or is otherwise unable to meet its full obligation pursuant to section 33681.12, by no later than May 15 of the applicable fiscal year, transfer any amount necessary to meet the obligations determined under section 33681.12 from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95) of the Revenue and Taxation Code.[88]

- If the legislative body of the relevant city or county, pursuant to Section 33681.12(d), reported to the county auditor that it intended to remit the amount required on behalf of the redevelopment agency and the legislative body fails to transmit the full amount as authorized by section 33681.12 by May 10 of the applicable fiscal year, by no later than May 15 of the applicable fiscal year, transfer an amount necessary to meet the redevelopment agency's obligation pursuant to section 33681.12 from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95) of the Revenue and Taxation Code. If the amount of the legislative body's allocations are not sufficient to meet the redevelopment agency's obligation pursuant to section 33681.12, transfer an additional amount necessary to meet the redevelopment agency's obligation from the property tax increment revenue apportioned to the redevelopment agency pursuant to Section 33670, provided that no moneys allocated to the agency's Low and Moderate Income Housing Fund shall be used for this purpose.[89]

<u>For the county auditor to perform the following activity beginning July 1, 2004:</u>

- If a redevelopment agency enters into an agreement with an authorized issuer, as defined, pursuant to section 33681.15, in order to obtain a loan, financed by bonds, to make the payment required by section 33681.12 to the county auditor for deposit in the county's ERAF, the county auditor shall receive a schedule of payments for that loan. And in the event the redevelopment agency fails to timely repay the loan in accordance with the schedule, the county auditor shall receive notification from the trustee for the bonds of the amount that is past due. The county auditor shall then reallocate funds from the legislative body of the community associated with a redevelopment agency and shall pay to the authorized issuer, on behalf of the redevelopment agency, the past due amount on the loan from the first available proceeds of the property tax allocation that would otherwise be transferred to the legislative body pursuant to Chapter 6 (commencing with Section 95) of Part 0.5 of Division 1 of the Revenue and Taxation Code. This transfer shall be deemed a reallocation of the property tax revenue from the legislative body to the

[87] Health and Safety Code section 33681.12(d) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[88] Health and Safety Code section 33681.13(e) (added by Stats. 2004, ch. 211 (SB 1096)

[89] Health and Safety Code section 33681.14(c) (added by Stats. 2004, ch. 211 (SB 1096)).

agency for the purpose of payment of the loan, and not as a payment by the legislative body on the loan.[90]

Reimbursement is not required to calculate the amount of moneys to be remitted to the county auditor by a redevelopment agency.[91]

d. Revenue and Taxation Code sections 97.31, 98.02, and 97.77, as added or amended by Statutes 2004, chapter 211 (SB 1096), Statutes 2004, chapter 610 (AB 2115)

Section 97.31, as amended by Statutes 2004, chapter 211 (SB 1096) provides for reductions of ERAF shifts in the 1993-1994 fiscal year. The prior section provided as follows:

> The Director of Finance may direct the county auditor to reduce the amount of the transfer to the Educational Revenue Augmentation Fund determined pursuant to subdivision (a) of Section 97.3 for any eligible county in accordance with subdivision (b) of this section, and also shall reduce the amount of that transfer for certain counties in accordance with subdivision (c).

The amended section provides:

> The Director of Finance shall direct the county auditor to reduce, in the 1993-94 fiscal year, the amount of the transfer to the Educational Revenue Augmentation Fund determined pursuant to subdivision (a) of Section 97.3 for any eligible county in accordance with subdivision (b) of this section, and also shall direct the county auditor to reduce, in the 1993-94 fiscal year, the amount of that transfer for certain counties in accordance with subdivision (c).

The claimant alleges that "Revenue and Taxation Code section 97.31 requires the County auditor to perform numerous duties at the request of the Department of Finance."[92] But any activities that might be found in the amended section are mandated for the 1993-1994 fiscal year, and are therefore outside the period of reimbursement for this test claim. The plain language of the amended section has no bearing on the 2004-2005 and 2005-2006 ERAF shift operations conducted by the counties.[93] The prior version of section 97.31 would have provided for reductions in the amounts shifted, without regard to the fiscal year in which the shift was to take place. If the statute had not been amended, its provision for reductions in the ERAF shift might have frustrated the intent of the Legislature with respect to the 2004-2005 and 2005-2006 fiscal year ERAF shifts, by permitting DOF to direct the county to reduce the amount of the ERAF shift in any given year. The Commission finds that section 97.31, as amended by Statutes 2004,

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[90] Health and Safety Code section 33681.15(e-g) (added by Stats 2004, ch. 610 (AB 2115)).

[91] Health and Safety Code section 33681.12 (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[92] Exhibit A, Test Claim Filing, at p. 73.

[93] Moreover, even if the statute is read to provide that DOF shall direct a county auditor, in the current year, to retroactively reduce allocations made in the 1993-1994 fiscal year, the counties have not pled any executive orders made by DOF, and therefore no reimbursable activities are found on the basis of this section.

chapter 211 (SB 1096) does not impose any new mandated activities upon local government within the period of reimbursement of this test claim.

Section 98.02 was amended by Statutes 2004, chapter 211 (SB 1096) to delete former subdivision (j), which required a county auditor to "compute an amount that is equal to 60 percent of the total amount transferred to all qualifying cities pursuant to this section…" There are no new mandated activities imposed by the deletion of this provision. The Commission finds that section 98.02, as amended, does not mandate a new program or higher level of service on counties and is, therefore, denied.

Section 97.77 provides that either an enterprise or nonenterprise special district "shall not pledge…through a bond covenant to pay debt service costs on debt instruments issued by the district, any ad valorem property tax revenue that would otherwise be dedicated to the reduction required by Sections 97.72 and 97.73." This section, as added by Statutes 2004, chapter 211 (SB 1096), prohibits certain actions by special districts, and does not impose any new mandated activities on counties. Section 97.77, as added, does not mandate a new program or higher level of service on counties and is, therefore, denied.

2. Vehicle License Fee Swap

The VLF Swap requires counties to redirect property taxes from the ERAF, or from school districts and community college districts if the ERAF is insufficient, in order to provide a more stable source of funding for city and county governments. The VLF Swap also provides funding levels that increase with property values in each successive year.[94]

a. Revenue and Taxation Code sections 97.70 and 97.76 (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats. 2004, ch. 610 (AB 2115))

Section 97.70 provides that a county auditor shall reduce the total amount of ad valorem property tax otherwise required to be allocated to a county's ERAF by the countywide VLF adjustment amount.[95] The section provides also that if, after performing the adjustments and allocations required by section 97.68, "there is not enough ad valorem property tax revenue that is otherwise required to be allocated to a county Educational Revenue Augmentation Fund for the auditor to complete the allocation reduction," the auditor shall reduce the total amount of ad valorem property tax revenue otherwise required to be allocated to school districts and community college districts in the county, in order to yield the remainder of the countywide VLF adjustment amount. Direct reductions to school districts and community college districts are made in proportion to each district's share of total ad valorem property tax revenue.[96] However, direct reductions to school districts and community college districts are prohibited for so-called "basic aid" districts, or those districts for which local revenues are sufficient to fund schools to the level

[94] Exhibit X, LAO Report, Insufficient ERAF, at p. 7.

[95] Revenue and Taxation Code section 97.70(a)(1)(A) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[96] Revenue and Taxation Code section 97.70(a)(1)(B) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

required by Proposition 98.[97] The countywide VLF adjustment amount is allocated to the Vehicle License Fee Property Tax Compensation Fund established in the treasury of each county.[98]

The auditor is required to allocate the moneys in the Vehicle License Fee Property Tax Compensation Fund to each city in the county, and to the county or city and county, based on each entity's VLF adjustment amount.[99] The auditor allocates one-half of the entity's VLF adjustment amount on or before January 31 of each fiscal year, and the other one-half on or before May 31 of each fiscal year.[100] The calculations required to determine the VLF adjustment amounts are as follows:

> (1)''Vehicle license fee adjustment amount'' for a particular city, county, or a city and county means, subject to an adjustment under paragraph (2) and Section 97.71, all of the following:
>
> (A) For the 2004–05 fiscal year, an amount equal to the difference between the following two amounts:
>
> (i) The estimated total amount of revenue that would have been deposited to the credit of the Motor Vehicle License Fee Account in the Transportation Tax Fund, including any amounts that would have been certified to the Controller by the auditor of the County of Ventura under subdivision (j) of Section 98.02, as that section read on January 1, 2004, for distribution under the law as it read on January 1, 2004, to the county, city and county, or city for the 2004–05 fiscal year if the fee otherwise due under the Vehicle License Fee Law (Pt. 5 (commencing with Section 10701) of Div. 2) was 2 percent of the market value of a vehicle, as specified in Section 10752 and 10752.1 as those sections read on January 1, 2004.
>
> (ii) The estimated total amount of revenue that is required to be distributed from the Motor Vehicle License Fee Account in the Transportation Tax Fund to the county, city and county, and each city in the county for the 2004–05 fiscal year under Section 11005, as that section read on the operative date of the act that amended this clause.
>
> (B) (i) Subject to an adjustment under clause (ii), for the 2005–06 fiscal year, the sum of the following two amounts:

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[97] Revenue and Taxation Code section 97.70(a)(1)(B) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)). See also Revenue and Taxation Code section 95, defining "excess tax school entity," also known as "basic aid" schools or school districts; Exhibit X, LAO Report: Insufficient ERAF, at p. 10 ["…state law does not allow county auditors to shift property taxes from basic aid districts to fund the VLF swap…"].

[98] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[99] Revenue and Taxation Code section 97.70(b)(1) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[100] Revenue and Taxation Code section 97.70(b)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

(I) The difference between the following two amounts:

(Ia) The actual total amount of revenue that would have been deposited to the credit of the Motor Vehicle License Fee Account in the Transportation Tax Fund, including any amounts that would have been certified to the Controller by the auditor of the County of Ventura under subdivision (j) of Section 98.02, as that section read on January 1, 2004, for distribution under the law as it read on January 1, 2004, to the county, city and county, or city for the 2004–05 fiscal year if the fee otherwise due under the Vehicle License Fee Law (Part 5 (commencing with Section 10701) of Division 2) was 2 percent of the market value of a vehicle, as specified in Sections 10752 and 10752.1 as those sections read on January 1, 2004.

(Ib) The actual total amount of revenue that was distributed from the Motor Vehicle License Fee Account in the Transportation Tax Fund to the county, city and county, and each city in the county for the 2004–05 fiscal year under Section 11005, as that section read on the operative date of the act that amended this sub-subclause.

(II) The product of the following two amounts:

(IIa) The amount described in subclause (I).

(IIb) The percentage change from the prior fiscal year to the current fiscal year in gross taxable assessed valuation within the jurisdiction of the entity, as reflected in the equalized assessment roll for those fiscal years. For the first fiscal year for which a change in a city's jurisdictional boundaries first applies, the percentage change in gross taxable assessed valuation from the prior fiscal year to the current fiscal year shall be calculated solely on the basis of the city's previous jurisdictional boundaries, without regard to the change in that city's jurisdictional boundaries. For each following fiscal year, the percentage change in gross taxable assessed valuation from the prior fiscal year to the current fiscal year shall be calculated on the basis of the city's current jurisdictional boundaries.

(ii) The amount described in clause (i) shall be adjusted as follows:

(I) If the amount described in subclause (I) of clause (i) for a particular city, county, or city and county is greater than the amount described in subparagraph (A) for that city, county, or city and county, the amount described in clause (i) shall be increased by an amount equal to this difference.

(II) If the amount described in subclause (I) of clause (i) for a particular city, county, or city and county is less than the amount described in subparagraph (A) for that city, county, or city and county, the amount described in clause (i) shall be decreased by an amount equal to this difference.

(C) For the 2006–07 fiscal year and for each fiscal year thereafter, the sum of the following two amounts:

(i) The vehicle license fee adjustment amount for the prior fiscal year, if Section 97.71 and clause (ii) of subparagraph (B) did not apply for that fiscal year, for that city, county, and city and county.

(ii) The product of the following two amounts:

(I) The amount described in clause (i).

(II) The percentage change from the prior fiscal year to the current fiscal year in gross taxable assessed valuation within the jurisdiction of the entity, as reflected in the equalized assessment roll for those fiscal years. For the first fiscal year for which a change in a city's jurisdictional boundaries first applies, the percentage change in gross taxable assessed valuation from the prior fiscal year to the current fiscal year shall be calculated solely on the basis of the city's previous jurisdictional boundaries, without regard to the change in that city's jurisdictional boundaries. For each following fiscal year, the percentage change in gross taxable assessed valuation from the prior fiscal year to the current fiscal year shall be calculated on the basis of the city's current jurisdictional boundaries.[101]

The *countywide* VLF adjustment amount is defined as the sum of the VLF adjustment amounts for all entities in the county. On or before June 30 of each fiscal year, the auditor is required to report to the State Controller the VLF adjustment amount for the county and each city in the county for that fiscal year, based on the calculations required in section 97.70(c)(1).[102] However, for the 2004-2005 and 2005-2006 fiscal years, section 97.76 requires the Controller to determine the countywide VLF adjustment amount, and the VLF adjustment amounts for each city and county, as follows:

(a) On or before September 1, 2004, the Controller shall determine the countywide vehicle license fee adjustment amount, as defined in Section 97.70, for the 2004–05 fiscal year and the vehicle license fee adjustment amount, as defined in Section 97.70, for each city, county, and city and county for the 2004–05 fiscal year, and notify the county auditor of these amounts.

(b) On or before September 1, 2005, the Controller shall determine the amount specified in clause (i) of subparagraph (B) of paragraph (1) of subdivision (c) of Section 97.70 for each city, county, and city and county and notify the county auditor of these amounts.[103]

Because the Controller is directed to calculate the adjustment amounts for the 2004-2005 and 2005-2006 fiscal years, the county auditor is only required to perform the above-described calculations under section 97.70(c)(1)(C), for the 2006-2007 fiscal year and after. The claimant requests reimbursement for "[r]eview of the VLF Adjustment amounts determined by the State Controller's Office," but no review is required by the plain language of the statutes. For the 2004-2005 and 2005-2006 fiscal years, the county auditor is only required to make the reductions in amounts identified by the Controller.

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[101] Revenue and Taxation Code section 97.70(c)(1) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[102] Revenue and Taxation Code section 97.70(c)(3) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[103] Revenue and Taxation Code section 97.76 (Stats. 2004, ch. 211 (SB 1096)).

The reductions and shifts of funds described above are mandated, based on the plain language of the statutes. These activities are also new, with respect to prior law. Therefore, the test claim statutes mandate a new program or higher level of service, within the meaning of article XIII B, section 6.

The Commission finds that Revenue and Taxation Code section 97.70, as added by Statutes 2004, chapter 211 (SB 1096), and amended by Statutes 2004, chapter 610 (AB 2115), requires each county to perform the following new activities:

Beginning July 1, 2004:

- Establish a Vehicle License Fee Property Tax Compensation Fund in the treasury of the county.[104] This is a one-time activity, by definition.
- Reduce the total amount of ad valorem property tax otherwise required to be allocated to a county's ERAF by the countywide VLF fee adjustment amount.[105]
- If, after performing the adjustments and allocations required by section 97.68, there is not enough ad valorem property tax revenue that is otherwise required to be allocated to a county ERAF for the auditor to complete the allocation reduction, the auditor shall also reduce the total amount of ad valorem property tax revenue otherwise required to be allocated to all school districts and community college districts in the county, to produce the remainder of the countywide VLF adjustment amount. Reductions to school districts and community college districts shall be made in proportion to each district's share of total ad valorem property tax revenue. School districts and community college districts subject to reductions when ERAF moneys are insufficient shall not include any districts that are excess tax school entities, as defined in Revenue and Taxation Code section 95.[106]
- Allocate the countywide VLF adjustment amount to the Vehicle License Fee Property Tax Compensation Fund established in the treasury of each county.[107]
- Allocate the moneys in the Vehicle License Fee Property Tax Compensation Fund to each city in the county, and to the county or city and county, based on each entity's VLF adjustment amount.[108] Allocate one-half of the entity's VLF adjustment amount on or

[104] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[105] Revenue and Taxation Code section 97.70(a)(1)(A) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[106] Revenue and Taxation Code section 97.70(a)(1)(B) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[107] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[108] Revenue and Taxation Code section 97.70(b)(1) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

before January 31 of each fiscal year, and the other one-half on or before May 31 of each fiscal year.[109]

- On or before June 30 of each fiscal year, report to the Controller the VLF adjustment amount for the county and each city in the county for that fiscal year.[110]

Beginning July 1, 2006:

- Calculate each entity's VLF adjustment amount, and the countywide VLF adjustment amount, defined as the sum of the VLF adjustment amounts of all entities in the county, pursuant to section 97.70(c)(1)(C).[111]

  This activity includes increasing the prior year's VLF fee adjustment amount for each entity based on the percentage change from the prior fiscal year to the current fiscal year in gross taxable assessed valuation within the jurisdiction of the entity, as reflected in the equalized assessment roll for those fiscal years.

Reimbursement is not required for calculating each entity's VLF adjustment amount for the 2004-2005 and 2005-2006 fiscal years.

b. Sections 96.81, 98.02, and 97.75, as added or amended by Statutes 2004, chapter 211 (SB 1096), and Statutes 2004, chapter 610 (AB 2115)

Section 96.81 is also alleged by the claimant to impose reimbursable state-mandated activities; section 96.81 provides as follows:

> Notwithstanding any other provision of law, the property tax apportionment factors applied in allocating property tax revenues in a county for which a Controller's audit conducted under Section 12468 of the Government Code between July 1, 1993, and June 30, 2001, determined that an allocation method was required to be adjusted and a reallocation was required for prior fiscal years, are deemed to be correct. However, for the 2001-02 fiscal year and each fiscal year thereafter, property tax apportionment factors applied in allocating property tax revenues in a county described in the preceding sentence shall be determined on the basis of property tax apportionment factors for prior fiscal years that have been fully corrected and adjusted, pursuant to the review and recommendation of the Controller, as would be required in the absence of the preceding sentence.[112]

The claimant alleges that this provision requires the counties to "redo property tax apportionment factors applied in allocating property tax revenues in a county based on property tax

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[109] Revenue and Taxation Code section 97.70(b)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[110] Revenue and Taxation Code section 97.70(c)(3) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[111] Revenue and Taxation Code section 97.70(c)(1)(C) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)). See also Revenue and Taxation Code section 97.76 (Stats. 2004, ch. 211 (SB 1096)).

[112] Exhibit A, Test Claim Filing, at p. 33; Revenue and Taxation Code section 96.81 (Stats. 2004, ch. 211 (SB 1096).

apportionment factors for prior fiscal years that have been fully corrected and adjusted, pursuant to the review and recommendation of the State Controller's Office."[113] But the plain language of the statute belies the existence of any new program or higher level of service. The first sentence above provides for a situation in which apportionment factors applied between 1993 and 2001 are deemed to be correct. The second sentence indicates that for the 2001-2002 fiscal year and after, apportionment factors must be determined on the basis of apportionment factors for prior fiscal year that have been fully corrected and adjusted, "*as would be required in the absence of the preceding sentence*." The Commission finds that no new mandated activities are imposed by this section; the section only provides for an exception, "deeming" correct the calculation of apportionment factors for prior years.

The claimant also requests reimbursement to "Calculate Unitary Tax Roll in excess of the 2%, beginning with fiscal year 2005-06. Note: AF91 for 2004-05. (See Volume III, pages 15-16)." It is unclear to which of the test claim statutes this activity refers. Moreover, pages 15-16 of Volume III of the claimant's filing show no connection to any statute or code section, or any narrative explanation of the claimed activity. This activity is therefore denied.

Section 98.02, also pled, addresses a number of special treatments or dispensations for the county of Ventura. This section was amended by Statutes 2004, chapter 211 to delete subdivision (j), which required the auditor to "compute an amount that is equal to 60 percent of the total amount transferred to all qualifying cities pursuant to this section," and to "certify that amount to the Controller for allocation of funds to the county pursuant to subdivision (a) of Section 11005." The Commission finds that there are no new mandated activities imposed by the deletion of that subdivision.[114]

Section 97.75 provides that for the 2004-2005 and 2005-2006 fiscal years, "a county shall not impose a fee, charge, or other levy on a city, nor reduce a city's allocation of ad valorem property tax revenue, in reimbursement for the services performed by the county under Sections 97.68 and 97.70." For the 2006-2007 fiscal year and each year thereafter, "a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy shall not exceed the actual cost of providing these services."[115] Section 97.68, as discussed in this analysis, constitutes the bulk of the Triple Flip activities required of counties. Section 97.70, as discussed above, details the requirements of the VLF Swap. Section 97.75 provides that a county may levy fees or charges against cities for services provided relating to the Triple Flip and the VLF Swap, but not until the 2006-2007 fiscal year. The Commission finds that section 97.75, as added by Statutes 2004, chapter 211 (SB 1096), does not impose any mandated activities upon local government. However, section 97.75 is analyzed below with respect to whether counties have incurred increased costs mandated by the state.

Accordingly, the Commission finds that Sections 96.81, 98.02, and 97.75, as added or amended by Statutes 2004, chapter 211, and Statutes 2004, chapter 610 do not mandate a new program or higher level of service on counties.

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[113] Exhibit A, Test Claim, Volume I, at p. 34.

[114] Revenue and Taxation Code section 98.02 (Stats. 2004, ch. 211 (SB 1096)).

[115] Revenue and Taxation Code section 97.75 (Stats. 2004, ch. 211 (SB 1096)).

3. Triple Flip Shift

In *City of Alhambra v. County of Los Angeles* the California Supreme Court explains the Triple Flip succinctly as follows:

> In 2004, the voters approved Proposition 57, the California Economic Recovery Bond Act, which allowed the state to sell up to $15 billion in bonds to close the state budget deficit. (Gov. Code, § 99050.) In order to create a dedicated revenue source to guarantee repayment of these bonds without raising taxes, the Legislature had passed already section 97.68, a temporary revenue measure that shifts revenue in a three-stage process known as the "Triple Flip." (Stats. 2003, 5th Ex.Sess.2003–2004, ch. 2, § 4.1.) In the first "flip," 0.25 percent of local sales and use tax revenues are diverted to the state for bond repayment. (§§ 97.68, subd. (b)(2), 7203.1, 7204.) In the second "flip," the lost local sales and use tax revenues are replaced by property tax revenue that would have been placed in the county ERAF but are instead set aside in a Sales and Use Tax Compensation Fund established in each county's treasury. (§ 97.68, subds.(a), (c)(1)-(6).) In the final "flip," any shortfall to schools caused by the reduction of funds to the county ERAF is compensated out of the state's general fund. This so-called "Triple Flip" is slated to end once the Recovery Act bonds are repaid. (§§ 97.68, subd. (b)(1), 7203.1; Gov. Code, § 99006, subd. (b).)[116]

a. Revenue and Taxation Code section 97.68 (added by Stats. 2003, ch. 162; amended by Stats. 2004, ch. 211 (SB 1096)).

Section 97.68 provides that during the "fiscal adjustment period," the amount otherwise required to be allocated to a county's ERAF shall be reduced by the county auditor by the "countywide adjustment amount," and deposited in a "Sales and Use Tax Compensation Fund" (SUTCF) established in the treasury of each county. The funds shifted from ERAF to the SUTCF are then to be back-filled by direct appropriations from the state to school districts and community colleges.[117]

During the fiscal adjustment period, "in lieu local sales and use tax revenues," defined as "revenues that are transferred under this section to a county or city from a Sales and Use Tax Compensation Fund or an Educational Revenue Augmentation Fund," shall be allocated among the county and cities in the county in amounts identified by Finance.[118] Finance is required to identify the portion of the countywide adjustment amount to be allocated to each city and to the county, and notify the county auditor of those amounts. Note that the claimant requests reimbursement for "review of the countywide adjustment amounts,"[119] but no such review is required by the plain language of the statutes, as discussed below. A county auditor "shall

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[116] *City of Alhambra v. County of Los Angeles* (2012) 55 Cal.4th 707, at pp. 715-716.

[117] Revenue and Taxation Code section 97.68 (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)). See also, Exhibit X, LAO Report, Insufficient ERAF, at p. 5.

[118] Revenue and Taxation Code section 97.68(c) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[119] Exhibit A, Test Claim, Volume I, at p. 31.

allocate one-half of the amount [identified by Finance for each city and for the county] in each January during the fiscal adjustment period and shall allocate the balance of that amount in each May during the fiscal adjustment period."[120]

At the end of each fiscal year, Finance recalculates the portions of the countywide adjustment amount estimated for the county, and for each city within the county, and notifies the county auditor of the corrected amount.[121] The county auditor then adjusts the allocation to that city or to the county in the following year, either transferring the difference from the SUTCF to the city or county, or reducing the amount otherwise allocated to the city or county and transferring that amount instead to the ERAF. If there are not sufficient funds remaining in the SUTCF to make the required adjustments, the county auditor shall transfer sufficient funds from the ERAF.

The fiscal adjustment period, during which these calculations and adjustments must be made, is defined as beginning in the 2004-2005 fiscal year, and extending until the Director of the Department of Finance notifies the State Board of Equalization that the period is over, and the bonds have been repaid.[122] That notification is provided for in Government Code 99006. Revenue and Taxation Code section 7203.1 explains also that when the notification provided for in section 99006 of the Government Code is made, the suspension of cities' and counties' authority to impose a 0.25% tax rate under Revenue and Taxation Code sections 7202 and 7203 is also ended (the 0.25% tax suspension is the first step of the Triple Flip, and represents the designated revenue stream for repaying the economic recovery bonds). Section 97.68(d) provides that when section 7203.1 "ceases to be operative," the countywide adjustment amount for the fiscal year in which that occurs is calculated differently, essentially providing for a pro-rata shift, based on the quarter of the fiscal year in which the suspension of sales and use tax authority is ended.[123]

The activities required of county auditors are mandatory, based on the plain language of the statute. The activities are also new; these shifts were not required under prior law. Finally, the activities required fall uniquely upon local government, except where DOF is required to calculate and identify the amounts to adjust, and recalculate based upon actual sales and use taxes not transmitted in a given fiscal year.[124] Therefore the activities discussed above impose a mandated new program or higher level of service upon counties, within the meaning of article XIII B, section 6.

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[120] Revenue and Taxation Code section 97.68(c)(2) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[121] Revenue and Taxation Code section 97.68(c)(3) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[122] Revenue and Taxation Code section 97.68(a-b) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[123] Revenue and Taxation Code section 97.68(d) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[124] *E.g.*, Revenue and Taxation Code section 97.68(b)(2); (c)(1) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

The remaining provisions of section 97.68 do not impose activities upon local government, but rather are prohibitive in nature. Section 97.68(e) provides that for the 2005-2006 fiscal year and thereafter, "the amounts determined under subdivision (a) of Section 96.1, or any successor to that provision, *may not reflect* any portion of any property tax revenue allocation required by this section for a preceding fiscal year." Section 97.68(f) provides that this section "*may not be construed* to do any of the following…" And section 97.68(g) states that existing tax exchange or revenue sharing agreements entered into prior to the operative date of this section shall be deemed to be temporarily modified to account for the reduced revenues. None of these provisions impose mandated activities upon counties, based on the plain language of the statute.

The Commission finds that Revenue and Taxation Code section 97.68, as added by Statutes 2003, chapter 162 (AB 1766), and amended by Statutes 2004, chapter 211 (SB 1096), mandates a new program or higher level of service on counties for the following activities, beginning in the 2004-2005 fiscal year:

- Establish a Sales and Use Tax Compensation Fund in the treasury of the county.[125] This is a one-time activity, by definition.

- During the fiscal adjustment period, reduce, by the countywide adjustment amount provided by the Department of Finance, the amount otherwise required to be allocated to a county's ERAF, and deposit that amount in the Sales and Use Tax Compensation Fund.[126]

  This section does not require the county to calculate the countywide adjustment amount; the amount is annually estimated by the Department of Finance, pursuant to section 97.68(b)(2), except in a fiscal year in which the suspension of 0.25 percent taxing authority is ended, pursuant to Revenue and Taxation Code section 7203.1.

- During the fiscal adjustment period, allocate revenues in the Sales and Use Tax Compensation Fund among the county and the cities in the county pursuant to the portions of the countywide adjustment amount identified by the Department of Finance for each city and for the county. Allocate one half of the amount identified for each city and for the county in each January during the fiscal adjustment period, and one half the amount identified for each city and for the county in each May during the fiscal adjustment period.[127]

  This section does not require the county auditor to calculate the portion of the countywide adjustment amount attributable to the county and each city within the county; the amounts are provided by the Department of Finance, pursuant to section 97.68(c)(1), and recalculated after the end of each fiscal year, pursuant to section

[125] Revenue and Taxation Code section 97.68(a)(2) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[126] Revenue and Taxation Code section 97.68(a-b) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[127] Revenue and Taxation Code section 97.68(c) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

97.68(c)(3), except a fiscal year in which the suspension of 0.25 percent taxing authority is ended, pursuant to Revenue and Taxation Code section 7203.1.

- If the amount recalculated by the Department of Finance after the end of each fiscal year based on the actual amount of sales and use taxes not transmitted for the prior fiscal year is greater than the amount allocated to a city or to the county based on the portion of the countywide adjustment amount estimated by the Department of Finance, transfer an amount of ad valorem property tax revenue equal to this difference from the Sales and Use Tax Compensation Fund to that local agency.[128]
- If the amount recalculated by the Department of Finance after the end of each fiscal year based on the actual amount of sales and use taxes not transmitted for the prior fiscal year is less than the amount allocated to a city or to the county based on the portion of the countywide adjustment amount estimated by the Department of Finance, in the fiscal year following the fiscal year for which the allocation was made, reduce the total amount of ad valorem property tax revenue otherwise allocated to that city or county from the Sales and Use Tax Compensation Fund by an amount equal to this difference and instead allocate this difference to the county ERAF.[129]
- If there is an insufficient amount of moneys in a county's Sales and Use Tax Compensation Fund to make the necessary transfers, transfer from the county ERAF to the Sales and Use Tax Compensation Fund an amount sufficient to make the full amount of these transfers.[130]
- If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on October 1 of any fiscal year:
    - Allocate that portion of the countywide adjustment amount attributable to the county and each city within the county on or before January 31 of that fiscal year. The countywide adjustment amount shall be defined as the combined total revenue loss to the county and each city within the county, as estimated by the director of the Department of Finance based on the prior year's *first quarter* sales and use tax revenues transmitted under section 7204; *plus* the difference between 1) the total amount allocated from the Sales and Use Tax Compensation Fund among the county and the cities in the county pursuant to the portions of the countywide adjustment amount identified by the Department of Finance in the prior year; and 2) the actual amount of sales and use tax not transmitted to all entities in the county for the prior year as a result of the 0.25% suspension of local sales and use tax authority.
    - If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent

[128] *Ibid.*

[129] *Ibid.*

[130] *Ibid.*

suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

- If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county Educational Revenue Augmentation Fund to that entity the difference between those amounts.[131]

  Section 97.68(d)(1) does not require the county auditor to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[132]

- If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on January 1 of any fiscal year:
  - Allocate that portion of the countywide adjustment amount attributable to the county and each city within the county; one half of the amount on or before January 31 of that fiscal year, and the remaining half of the amount on or before May 31 of that fiscal year. The countywide adjustment amount shall be defined as the combined total revenue loss to the county and each city within the county, as estimated by the director of the Department of Finance based on the sales and use tax revenues transmitted under section 7204 for the *first two quarters* of the prior fiscal year as determined by the Board of Equalization and reported to the director on or before that August 15; *plus* the difference between the total amount allocated to all entities in the county in the prior year and the actual amount of sales and use tax not transmitted to all entities in the county for the prior year.
  - If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

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[131] Revenue and Taxation Code section 97.68(d)(1) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[132] Revenue and Taxation Code section 97.68(c)(3); (d)(1)(C)(ii) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

- If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[133]

  Section 97.68(d)(2) does not require the county auditor to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[134]

- If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on April 1 of any fiscal year:
  - Reduce the amount otherwise required to be allocated in May of that fiscal year from the Sales and Use Tax Compensation Fund by the amount reported by director representing that portion of the countywide adjustment amount attributable to the estimated sales and use tax revenue losses resulting from the rate suspension applied by section 7203.1 for the fourth quarter of that fiscal year for the county and each city in the county.
  - After May allocations have been made, transfer any moneys remaining in the county Sales and Use Tax Compensation Fund to the county ERAF.
  - If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of that fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.
  - If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or

[133] Revenue and Taxation Code section 97.68 (d)(2) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[134] Revenue and Taxation Code section 97.68(c)(3); (d)(2)(C)(ii) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[135]

Section 97.68(d)(3) does not require the county auditor to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[136]

- If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on July 1 of any fiscal year:
  - If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of that fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.
  - If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts. [137]

    Section 97.68(d)(4) does not require the county auditor to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[138]

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[135] Revenue and Taxation Code section 97.68(d)(3) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[136] Revenue and Taxation Code section 97.68(c)(3); (d)(3)(C)(ii) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[137] Revenue and Taxation Code section 97.68(d)(4) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[138] Revenue and Taxation Code section 97.68(c)(3); (d)(4)(B)(2) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

B. Some of the test claim statutes impose increased costs mandated by the state on counties within the meaning of Government Code section 17514.

Government Code section 17514 provides that "'[c]osts mandated by the state' means any increased costs which a local agency or school district is required to incur after July 1, 1980, as a result of any statute enacted on or after January 1, 1975, or any executive order implementing any statute enacted on or after January 1, 1975, which mandates a new program or higher level of service of an existing program within the meaning of Section 6 of Article XIII B of the California Constitution." Government Code section 17564 provides that "[n]o claim shall be made pursuant to Sections 17551, 17561, or 17573, nor shall any payment be made on claims submitted pursuant to Sections 17551, or 17561, or pursuant to a legislative determination under Section 17573, unless these claims exceed one thousand dollars."

The claimant has presented a cost study, based on survey responses of county staff, and including a number of planning, implementation, and administrative duties that LA County identifies as being required by the test claim statutes. Many of the activities for which the claimant has presented cost data are indeed mandated by the plain language of the test claim statutes. For example, establishing new accounts, such as the Vehicle License Fee Property Tax Compensation Fund, and the Sales and Use Tax Compensation Fund, is clearly required by the plain language, as discussed above. Similarly, allocating and adjusting revenues as directed by DOF and SCO, is clearly mandated, as discussed above. However, a number of activities alleged in the cost study, such as "[r]eview of the 'countywide adjustment amounts' for the Sales and Use Tax and Vehicle License Fee as submitted by [DOF]," analyze the legislation and conduct training for county departments, or answer questions from other taxing jurisdictions in the county, are not required by the plain language of the test claim statutes. These activities may be reasonably necessary to comply with the mandate, as determined at the parameters and guidelines phase, and will require evidence in the record. That evidence must demonstrate that the alleged reasonably necessary activities are reasonably necessary to implement the reimbursable activities mandated by the test claim statutes and approved in this test claim decision. All alleged costs, however, are included in the cost study provided by the claimant.

The claimant estimates costs to implement the ERAF III, VLF Swap, and Triple Flip for the 2004-2005 and 2005-2006 fiscal years to be $13,301,018, and $12,580,829, respectively.[139] The claimant is only required to allege increased costs of $1000 and the costs alleged clearly exceed the initial $1000 requirement.[140]

However, further analysis is required to determine if any of the exceptions to "costs mandated by the state" in Government Code section 17556 are applicable.

1. Fee authority authorized by Revenue and Taxation Code section 97.75 applied to mandated activities under the VLF Swap and Triple Flip ends reimbursement for those activities on June 30, 2006, with one exception (Gov. Code, § 17556(d)).

Government Code section 17556 provides, in pertinent part, that the Commission "shall not find" costs mandated by the state, if:

[139] Exhibit B, Test Claim Volume II, at pp. 6-29.

[140] Government Code section 17564.

> The local agency or school district has the authority to levy service charges, fees, or assessments sufficient to pay for the mandated program or increased level of service. This subdivision applies regardless of whether the authority to levy charges, fees, or assessments was enacted or adopted prior to or after the date on which the statue or executive order was enacted or issued.[141]

The claimant argues that "funding disclaimers are not available to bar recovery of otherwise reimbursable costs." The claimant cites to Revenue and Taxation Code section 97.75, which specifically bars, for the 2004-2005 and 2005-2006 fiscal years, the imposition of a fee or other levy by a county upon a city, "in reimbursement for the services performed by the county under sections 97.68 and 97.70."[142] For those years, then, no fees are permitted, with respect to the VLF Swap mandated under section 97.70 or the Triple Flip mandated by section 97.68. The claimant argues:

> Here the County has no authority to levy service charges, fees or assessments under the test claim legislation or under other authority. In fact the test claim legislation explicitly prohibits the County from imposing a service charge, fee or assessment to pay for services claimed herein under Revenue and Taxation Code Section 97.75.[143]

However, the same section goes on to state that for fiscal year 2006-2007 and after, "a county *may impose a fee, charge, or other levy on a city for these services,*" not to exceed the actual costs of providing these services.[144] Section 97.75 states, in its entirety:

> Notwithstanding any other provision of law, for the 2004–05 and 2005–06 fiscal years, a county shall not impose a fee, charge, or other levy on a city, nor reduce a city's allocation of ad valorem property tax revenue, in reimbursement for the services performed by the county under Sections 97.68 and 97.70. For the 2006–07 fiscal year and each fiscal year thereafter, a county may impose a fee, charge, or other levy on a city for these services, but the fee, charge, or other levy shall not exceed the actual cost of providing these services.[145]

The provision authorizes a county to charge the cities for the costs of performing the "services" required by the Triple Flip and the VLF Swap in 2006-2007 or after, but the section is not clear with respect to what "services" may give rise to costs chargeable against the cities. The California Supreme Court addressed the extent of this fee authority, though on an unrelated claim, in *City of Alhambra, supra*: "we conclude that section 97.75 permits a county to charge cities for only the new, incremental costs associated with a county auditor's services in administering the Triple Flip and VLF Swap."[146] The court analyzed the term "services," as used in section 97.75, holding that the provision "merely authorizes counties to demand from

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[141] Government Code section 17556(d) (Stats. 2010, ch. 719 (SB 856)).

[142] Revenue and Taxation Code section 97.75 (Stats. 2004, ch. 211 (SB 1096)).

[143] Exhibit A, Test Claim, at p. 125.

[144] *Ibid.*

[145] Revenue and Taxation Code section 97.75 (Stats. 2004, ch. 211 (SB 1096)).

[146] 55 Cal.4th 707, at p. 720.

cities payment for only the actual cost of *administering the Triple Flip and VLF Swap* and nothing more." Based on the court's conclusion in *City of Alhambra*, counties are permitted to charge cities for the actual costs of administering the Triple Flip and the VLF Swap, which includes, as discussed above, calculating VLF adjustment amounts, for the county and each city within the county, beginning in fiscal year 2006-2007.[147]

In *Connell v. Superior Court*,[148] the court of appeal held that reimbursement was barred where water districts had authority to levy sufficient fees or charges to cover the costs of mandated activities, notwithstanding the districts' demonstration that such fees were not economically feasible. Similarly, in *Clovis Unified School District v. Chiang*,[149] the court of appeal upheld the Controller's decision to reduce reimbursement to the extent of authorized fees, whether the community colleges chose to exercise their authority or not. Here, as a matter of law, the counties have the authority to impose a fee or charge upon the cities for the administrative costs of implementing the VLF Swap and the Triple Flip, beginning in the 2006-2007 fiscal year. Given that the administrative costs of the VLF Swap and Triple Flip programs are the only costs alleged in this test claim, and based on the reasoning of *Connell*, and *Clovis*, *supra*, the Commission cannot find costs mandated by the state, in the face of sufficient fee authority, beginning on July 1, 2006 (fiscal year 2006-2007).

The supplemental filing submitted by the claimant continues to stress, relying on section 97.75, that "costs incurred in performing the work necessary to comply with the sections 97.68 and 97.70, for fiscal year 2004-05 and 2005-06 as detailed in Attachment A, are recoverable solely under the subject test claim."[150] The claimant's exhibits and submissions,[151] as well as the test claim narrative itself,[152] fail to acknowledge the express fee authority provided in the second sentence, and instead focus on the prohibition found in the first sentence, with one exception: the document, "SB 1096 Guidelines," submitted by the claimant in support of the test claim, acknowledges that in 2006-2007 and after, counties will be authorized to allocate against the cities the costs of administering the VLF Swap and the Triple Flip.[153] The SB 1096 Guidelines were in part the subject of dispute in *City of Alhambra*, *supra*, but the issue before the court was not *whether* counties could recoup costs of administering the Triple Flip and VLF Swap, but the *method* by which those costs could be recouped.[154]

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[147] See Revenue and Taxation Code sections 97.70(c)(1), and 97.76, as added or amended by Statutes 2004, chapter 2119 (SB 1096), and Statutes 2004, chapter 610 (AB 2115).

[148] (Cal. Ct. App. 3d Dist. 1997) 59 Cal.App.4th 382.

[149] (Cal. Ct. App. 3d Dist. 2010) 188 Cal.App.4th 794.

[150] Exhibit F, Claimant's Supplemental Filing on Fee Information, at p. 2.

[151] See, e.g., Declaration of Kelvin Aikens, Exhibit B, Volume II-Declarations, at p. 5; Declaration of Darlene Hoang, Exhibit B, Volume II-Declarations, at p. 33.

[152] Exhibit A, Test Claim, at pp. 11-12.

[153] See "SB 1096 Guidelines," authored by the Accounting Standards Committee of the California State Association of Auditors, Exhibit D, Volume IV Documentation, at p. 117.

[154] 55 Cal.4th at pp. 718-720.

But in this context the case of the City and County of San Francisco demands a different result. Where in *Connell* the water districts were authorized to charge users to cover the costs of mandated activities, and in *Clovis* the community college districts were authorized to charge students, up to a certain amount, for their health services, here the counties are authorized to charge cities for the administrative costs of the VLF Swap and the Triple Flip. For all other cities that authority is sufficient to offset the costs of the mandate, and leads to a conclusion that no increased costs are incurred. This is so because, article XIII B, section 6 is intended to protect the tax revenues of the local government;[155] if a source of revenue other than the local proceeds of taxes is available to cover the costs of the mandate, reimbursement must either be denied (*Connell*, *supra*), or offset to the extent of the available revenue (*Clovis*, *supra*). Here, while the City and County of San Francisco is required to perform the reductions and transfers under sections 97.70 and 97.68, just as is every other county, the City and County of San Francisco is one consolidated local government with no separate or subordinate city government upon which to levy a fee or charge; the county would in effect be charging itself, which cannot logically be characterized as anything other than the proceeds of local taxes.[156,157]

Similarly, in *City of San Jose*,[158] counties were authorized to charge cities and school districts for the costs of booking suspects into the county jail who were arrested within the jurisdiction of the cities or school districts. The court held that cities were not eligible for reimbursement of costs shifted from one local entity to another in this manner, because the charges were not costs mandated by the state, but imposed by another local government entity. But the City and County of San Francisco, *acting as a county*, could not, and logically would not, have availed itself of the authority to charge the city for booking arrestees under those statutes, because the jurisdiction of the City and County is one and the same. Therefore the City of San Francisco would not have incurred costs under that statute, as did the City of San Jose.

In the context of the statutes addressed in *City of San Jose*, *supra*, the City of San Francisco would not have incurred costs exacted by the County, because the jurisdiction of local law enforcement and the courts is unified. In the context of the statutes addressed in *Connell*, *supra*, there was a subordinate entity that the districts were empowered to charge, to generate offsetting revenues in the form of fees. And, in the context of *Clovis, supra*, there was a "user" that the community college districts were authorized to charge. Here, there is no subordinate entity for

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[155] See *County of Fresno v. State of California* (1991) 53 Cal.3d 482, at p. 487.

[156] *County of Fresno*, *supra*, at p. 487 [Section 17556 "effectively construes the term 'costs' in the constitutional provision as excluding expenses that are recoverable from sources other than taxes."]

[157] See Government Code section 23138, defining the boundaries of San Francisco city and county. See also San Francisco Administrative Code, section 2.1-1 ["The powers of the City and County, except the powers reserved to the people or delegated to other officials, boards or commissions by the Charter, shall be vested in the Board of Supervisors and shall be exercised as provided in the Charter. [¶]The exercise of all rights and powers of the City and County when not prescribed in the Charter shall be as provided by ordinance or resolution of the Board of Supervisors."] (Ordinance 65-13, File No. 130018, approved April 17, 2013, effective May 17, 2013.)

[158] *City of San Jose v. State of California* (Cal. Ct. App. 6th Dist. 1996) 45 Cal.App.4th 1802.

the City and County of San Francisco to impose the charges upon; and the City and County is mandated to incur the same costs as other counties.

Therefore the Commission finds that section 17556(d) does not bar the Commission from finding costs mandated by the state in fiscal year 2006-2007 and after, within the meaning of Government Code section 17514, *for the City and County of San Francisco only*. As for all other counties, section 97.75 provides for sufficient fee authority to cover the costs of mandated activities beginning in fiscal year 2006-2007, and therefore no costs mandated by the state may be found after June 30, 2006. Thus reimbursement is required for the City and County of San Francisco beginning in the 2004-2005 fiscal year, and continuing for each fiscal year that the City and County can show increased costs. For all other counties, reimbursement is required only for the 2004-2005 and 2005-2006 fiscal years for the administrative activities required by sections 97.68 and 97.70.

2. There is no evidence of offsetting savings or revenues to pay for the program pursuant to Government Code section 17556(e)

Section 17556(e) provides that the Commission shall not find costs mandated by the state if:

> The statute, executive order, or an appropriation in a Budget Act or other bill provides for offsetting savings to local agencies or school districts that result in no net costs to the local agencies or school districts, or includes additional revenue that was specifically intended to fund the costs of the state mandate in an amount sufficient to fund the cost of the state mandate. This subdivision applies regardless of whether a statute, executive order, or appropriation in the Budget Act or other bill that either provides for offsetting savings that result in no net costs or provides for additional revenue specifically intended to fund the costs of the state mandate in an amount sufficient to fund the cost of the state mandate was enacted or adopted prior to or after the date on which the statute or executive order was enacted or issued.[159]

The claimant asserts that section 17556(e) does not bar reimbursement of this test claim, as follows:

> No offsetting savings to local agencies or school districts were provided. Further, no revenue that was specifically intended to fund the costs of the State mandates claimed herein was provided. In this regard, no dedicated State, federal, local, or other non-local funds was available to implement the test claim legislation.[160]

There is nothing in the plain language of the test claim statutes, or of any other law revealed in the record, that provides offsetting savings, or additional revenue specifically intended to fund the costs of the mandated activities. The Commission finds that section 17556(e) does not bar reimbursement.

3. The voter initiative exception to reimbursement in Government Code section17556(f) does not apply

[159] Government Code section 17556(e) (Stats. 2010, ch. 719 (SB 856)).

[160] Exhibit A, Test Claim, at p. 126.

The claimant notes that Propositions 1A and 57 are both potentially relevant to this claim, but argues that neither Proposition 1A, nor Proposition 57, is sufficiently related to the ERAF or VLF shifting provisions of the test claim statutes.[161] The claimant argues that section 17556(f) is not applicable, as follows:

> Prop lA guarantees 0.65% VLF rate to cities and counties. The VLF/property tax Swap is statutory and is not referred to in any way by Proposition 1A. There's nothing in Proposition 1A that otherwise contemplates, refers to, or obliquely references ERAF III. While Proposition lA does reference the triple flip, it only prohibits the Legislature from extending the triple flip beyond the date on which it terminates according to the existing statute (the day the fiscal recovery bonds are paid off). However, the triple flip is not "reasonably within the scope of" Proposition lA simply because the same subject matter is referenced.
>
> Proposition 57 added Government Code section 99072(c) which pledges revenues raised from the additional 1/4 cent sales tax to the "Fiscal Recovery Fund" to pay off the fiscal recovery bond. Section 99072(c), however, it is [*sic*] not part of the test claim legislation. Further, there is nothing in Prop 57 which indicates that the additional 1/4 cent sales tax, requiring a "triple flip", [*sic*] is "necessary to implement Prop 57.["]
>
> With respect to whether "triple flip" is "reasonably within the scope of" Proposition 57, the test claim legislation goes far beyond any bond financing scheme envisioned by the framers of Prop 57. In this regard, the Senate Floor Analysis of SB 1096, included herein in Volume II, page 157, indicates that SB 1096 "contains legislative findings and declarations that this entire measure [including the "triple flip"] is a comprehensive revision to local government finances ...", [*sic*] not encompassed by Prop 57.
>
> Further, SB 1096 was not affected by Proposition 65 either. Prop 65 was not approved by the voters in the November 2, 2004 general election and, accordingly, is also not applicable here.
>
> Therefore, the ballot initiative funding disclaimer set forth in Government Code Section 17556 (f) does not bar the recovery of 'costs mandated by the state', [*sic*] as defined in Government Code Section 17514.[162]

Section 17556(f) provides that the Commission shall not find costs mandated by the state if:

> The statute or executive order imposes duties that are necessary to implement, or are expressly included in, a ballot measure approved by the voters in a statewide or local election. This subdivision applies regardless of whether the statute or

[161] Exhibit A, Test Claim, at pp. 12, Fn 3.

[162] Exhibit A, Test Claim, at pp. 125-126 [As noted above, at the time this test claim was filed, section 17556(f) prohibited a finding of costs if the test claim statute imposed duties "necessary to implement, reasonably within the scope of, or expressly included in" a ballot measure.].

executive order was enacted or adopted prior to or after the date on which the ballot measure was approved by the voters.[163]

California School Boards Association v. State of California (*CSBA I*) makes clear that the statutory exclusion from reimbursement contained in the first sentence is consistent with the subvention requirements of article XIII B, section 6.[164] The court in *CSBA I* reasoned that the subvention requirement applies to mandates imposed by the Legislature, not by the voters; the voters' powers of initiative and referendum are reserved powers, and not vested in the Legislature, and are therefore not limited by article XIII B, section 6. *CSBA I* holds that the reimbursement requirement applies only to state-mandated costs, not costs incurred by way of "the people acting pursuant to the power of initiative."[165]

"Having established that costs imposed on local governments by ballot measure mandates need not be reimbursed by the state," and thus approving the statutory exclusion to the extent of statutes "expressly included in" a ballot measure, the court considered also whether activities embodied in a test claim statute that are "necessary to implement" a voter-enacted ballot measure are subject to reimbursement. In *San Diego Unified School District v. Commission on State Mandates*, costs that were incidental to a federal mandate were not reimbursable under section 17556(c), because those costs were imposed under Education Code provisions "adopted to implement a federal due process mandate." The *CSBA I* court concluded that "[t]he language of [section 17556(f)] relieving the State of the obligation to reimburse a local government for duties 'necessary to implement' a ballot measure is *unobjectionable* because it corresponds to the Supreme Court's holding in *San Diego Unified* that state statutes codifying federal mandates are not reimbursable."[166,167] The court also held that the "necessary to implement" test of section 17556(f) should be strictly construed; that the language was actually *narrower* than the "adopted to implement" language regarding federal mandates, approved in *San Diego Unified*.[168] The court at the same time struck down, as being overbroad, the "reasonably within the scope of" language also provided in subdivision (f), and the Legislature amended the code section the following year to excise the offending language.[169]

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[163] Government Code section 17556(f) (Stats. 2010, ch. 719, (SB 856)).

[164] *California School Boards Association v. State of California* (*CSBA I*) (Cal. Ct. App. 3d Dist. 2009) 171 Cal.App.4th 1183, 1206-1207; 1210.

[165] *Ibid.*

[166] *San Diego Unified*, *supra*, (2004) 33 Cal.4th 859.

[167] *California School Boards Association v. State* (*CSBA I*) (Cal. Ct. App. 3d Dist. 2009) 171 Cal.App.4th 1183, at p. 1213 [emphasis added].

[168] *Ibid.*

[169] Government Code section 17556(f) (Stats. 2010, ch. 719 (SB 856) [amended to remove "reasonably within the scope of," as an alternative test to "expressly included in," or "necessary to implement," consistent with the court's decision in *CSBA I*, *supra*]). Note that the test claim invokes the "reasonably within the scope of" language, which was still in force at the time of filing.

Section 17556(f) also states that the rule "applies regardless of whether the statute or executive order was adopted prior to or after the date on which the statute or executive order was enacted or issued." This provision, like the "reasonably within the scope of," and "necessary to implement" tests, first appeared in section 17556 in 2005.[170] This last provision, stating that the order of enactment is not material to the analysis under section 17556(f), has not yet been determined in the courts.[171] However, the Commission must presume that the statutes enacted by the Legislature are constitutional,[172] and therefore if a voter-enacted ballot initiative embracing the same subject matter were to be enacted either before or after a test claim statute, an analysis under section 17556(f) would be in order.

Despite the claimant's protestations that Propositions 1A and 57 have no bearing on the test claim statutes, the following analysis will show that there is indeed a connection, and that the propositions in question embraced much of the same subject matter. However, the analysis ultimately concludes that reimbursement is not barred by section 17556(f), because the test claim statutes do not impose duties *expressly included in* or *necessary to implement* the ballot measures in question.

a. Proposition 57 and the Triple Flip

On August 2, 2003, the Governor signed into law a bond repayment mechanism now known as the Triple Flip. Section 97.68 required a county auditor to reduce and shift funds from the county's ERAF to the Sales and Use Tax Compensation Fund, as discussed above, and to allocate the moneys in the SUTCF to cities and counties, "to reimburse these entities for local tax revenue losses resulting from a specified statute, as provided." The "specified statute" was Statutes 2003-2004, 1st Extraordinary Session, chapter 13 (AB 1X7), in which the Legislature suspended the sales and use tax authority of local government in order to repay recovery bonds authorized by the Legislature.[173] That statute was challenged in the courts, and no bonds were issued.[174]

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[170] As discussed above, the "reasonably within the scope of" test has been disapproved by the courts and removed from the code; compare Statutes 2004, chapter 895 (AB 2855) to Statutes 2005, chapter 72 (AB 138).

[171] The constitutionality of Government Code sections 17570, in conjunction with the amendments to section 17556, is being challenged in *California School Boards Assoc., et al. v. State of California, Commission on State Mandates, John Chiang, as State Controller, and Ana Matosantos, as Director of the Department of Finance,* Alameda County Superior Court, Case No. RG11554698.

[172] *California School Boards Association v. State of California,* (*CSBA II*) (Cal. Ct. App. 4th Dist. 2011) 192 Cal.App.4th 770, 795; *Porter v. City of Riverside* (1968) 261 Cal.App.2d 832, 837.

[173] Exhibit X, AB 1766 Bill Analysis, at p. 1. See also Government Code section 99006; Revenue and Taxation Code section 7203.1 (Stats. 2003-2004, 1st Ex. Sess., ch. 13 (AB 1X7)) [repealed and replaced by Stats. 2003-2004, 5th Ex. Sess., ch. 2 (AB 5X9)].

[174] Exhibit X, Voter Information Guide, Supplemental, March 2, 2004, at p. 7.

In December 2003, the Legislature passed, in the 5th extraordinary session, a bill repealing and adding provisions of the Government Code and the Revenue and Taxation Code, relating to fiscal recovery financing: AB5X 9. Additions to the Government Code included section 99050 et seq., which provided authority to issue more bonds, raising greater revenues, to address the state's mounting budget shortfall; the bond provisions were contingent on voter approval at the March 2004 primary election. AB5X 9 also repealed and reenacted section 7203.1 of the Revenue and Taxation Code, which provides for repayment of the deficit financing bonds created by section 99050 et seq., by suspending, until the bonds are repaid, a portion of local governments' authority to impose sales and use taxes, and redirecting funds that would otherwise be raised by those sales and use taxes to repay the bonds. The earlier bond repayment scheme had called for a one-half percent reduction of sales and use tax authority; the later provisions called for a one-quarter percent reduction.[175] AB 5X9 also repealed and reenacted section 97.68 of the Revenue and Taxation Code, which, as discussed above, requires redirecting property tax revenues otherwise required to be allocated to the ERAF, and distributing those to the counties and cities, to make up for the lost sales and use tax revenue.[176] Section 97.68 was amended by AB 5X9 to incorporate subdivision (g), stating that existing tax exchange or revenue sharing agreements involving local agencies would be deemed modified to account for the reduced revenues; the earlier statute had contained similar language in the uncodified section of the bill.[177,178] However, AB 5X9 did not add any new *activities* to be performed by local government and so was not pled in this test claim.

In March 2004 the voters passed Propositions 57 and 58, adopting both the economic recovery bond and the Balanced Budget Act, which, according to the ballot materials, were each contingent upon the other being adopted.[179] The adoption of Propositions 57 and 58 also made sections 7203.1 and 97.68 of the Revenue and Taxation Code operative, pursuant to section 8 of AB5X 9, thus providing for a steady stream of revenue to repay the bonds.

On August 5, 2004, the Legislature enacted Statutes 2004, chapter 211 (SB 1096), which amended section 97.68 by adding a new subdivision (d). The former provision simply provided:

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[175] *Compare* Revenue and Taxation Code section 7203.1 (Stats. 2003-2004, 1st Ex. Sess., ch. 13 (AB 1X7)) *with* Revenue and Taxation Code section 7203.1 (Stats. 2003-2004, 5th Ex. Sess., ch. 2 (AB 5X9)).

[176] Revenue and Taxation Code section 97.68 (Stats. 2003-2004, 5th Ex. Sess., ch. 2 (AB 5X9)).

[177] See Statutes 2003, ch. 162 (AB 1766) section 2.

[178] The repeal and reenactment of the Triple Flip had no effect on the underlying law with respect to mandates. See *In re Dapper*, 71 Cal.2d 184, at p. 189, citing *Sobey v. Molony*, 40 Cal.App.2d, 381, at p. 385 ["When a statute, although new in form, re-enacts an older statute without substantial change, even though it repeals the older statute, the new statute is but a continuation of the old. There is no break in the continuous operation of the old statute, and no abatement of any of the legal consequences of acts done under the old statute."]

[179] See Exhibit X, Voter Guide, Supplemental, March 2, 2004 Primary Election, at p. 10 ["The California Economic Recovery Bond Act will not take effect unless voters approve the California Balanced Budget Act, which PROHIBITS BORROWING TO PAY DEFICITS ever again and requires enactment of a BALANCED BUDGET."].

(d)(1)If Section 7203.1 ceases to be operative during any calendar quarter that is not the calendar quarter in which the fiscal year begins, the excess amount, as defined in paragraph (2), of the county and each city in the county shall be reallocated from each of those local agencies to the Educational Revenue Augmentation Fund.

(2) For purposes of this subdivision, "excess amount" means the product of both of the following:

(A) The total amount of ad valorem property tax revenue allocated to that local agency pursuant to paragraph (2) of subdivision (c).

(B) That percentage of the fiscal year in which Section 7203.1 is not operative.

Amended subdivision (d) provides for a specific calculation of the countywide adjustment amount in the final year of the fiscal adjustment period, depending on the quarter of the fiscal year in which the bonds are repaid and the suspension of sales and use tax authority is ended. Because amended subdivision (d) provides for an alternative calculation of the countywide adjustment amount, several other provisions of section 97.68 were amended to read, "except as otherwise provided in subdivision (d)."[180]

Statutes 2004, chapter 211 (SB 1096) also amended sections 97.31 and 98.02 of the Revenue and Taxation Code, and added sections 96.81, 97.70, 97.71, 97.72, 97.73, 97.74, 97.75, 97.76, and 97.77 to the Revenue and Taxation Code, and 33681.12, 33681.13, and 33681.14 to the Health and Safety Code. These added sections address the swap of VLF revenues otherwise allocated to the ERAF to cities and counties, and the ERAF III shift, from cities, counties, cities and counties, redevelopment agencies, and special districts. Neither of those programs is directly relevant to the deficit financing bond created by AB5X 9, and enacted by the voters in Proposition 57.

Section 17556(f) only bars reimbursement of mandated increased costs where the mandate imposes duties expressly included in or necessary to implement a voter-enacted ballot measure. As discussed above, the "necessary to implement" test is interpreted very narrowly by the courts. Here, the economic recovery bonds adopted by the voters in Proposition 57 arguably precipitated the Triple Flip, and the ERAF III shift, and perhaps even the VLF Swap. And furthermore, the Triple Flip in particular would not have been made effective without the voters' action. However, there are any number of methods or means that the Legislature *might have chosen* to repay the recovery bonds, and neither the Triple Flip, nor the other two programs, were expressly included in Proposition 57, or "necessary" to implement Proposition 57.[181] Clearly, when Proposition 57 was put before the voters the Legislature had already chosen its preferred solution to repay the bond, if authorized: the Triple Flip had already been put in place; but in no event can it be argued that the Triple Flip was "necessary to implement" the ballot measure, because the ballot measure only approved the state entering into debt to address a then-existing budget shortfall. The ballot measure did not compel any particular method or means by which the debt would be repaid. The Voter Information Guide may be argued to have hinted at the Triple Flip: "[t]he repayment of the bond would result in annual General Fund costs equivalent to one-

[180] Revenue and Taxation Code section 97.68 (as amended by Statutes 2004, chapter 211 (SB 1096)).

[181] See *CSBA I, supra* ["necessary to implement" test strictly construed].

quarter cent of California's sales tax revenues,"[182] but that statement does not require the reduction of local sales and use tax authority as a means to repay the bonds. Moreover, the oblique reference to "costs equivalent to one-quarter cent" of sales tax revenues, even if it could be argued to make necessary a reduction of local revenue such as imposed by Revenue and Taxation Code section 7203.1, falls short of *requiring* the "elaborate provisions," and the "many accounting functions not previously required," which were envisioned by the Legislature to reimburse local government for the tax revenue lost.[183]

b. Proposition 1A, and The Triple Flip, ERAF III, and VLF Swap

On November 2, 2004, the voters adopted Proposition 1A. Proposition 1A was intended, according to the ballot pamphlet materials, to restrict the Legislature's ability to manipulate local revenues. The Voter Information Guide explains that Proposition 1A "amends the State Constitution to significantly reduce the state's authority over major local government revenue sources." The "major local government revenue sources" include local sales taxes, property taxes, and the VLF. Proposition 1A:

1) [P]rohibits the state from: reducing any local sales tax rate, limiting existing local government authority to levy a sales tax rate, or changing the allocation of local sales tax revenues...

2) [G]enerally prohibits the state from shifting to schools or community colleges any share of property tax revenues allocated to local governments for any fiscal year under the laws in effect as of November 3, 2004…[and]…

3) If the state reduces the VLF rate below its current level, the measure requires the state to provide local governments with equal replacement revenues.[184]

Proposition 1A added article XIII, section 25.5 of the California Constitution, to provide that "[o]n or after November 3, 2004, the Legislature shall not enact a statute to do any of the following:"

> (1)(A) Except as otherwise provided in subparagraph (B), modify the manner in which ad valorem property tax revenues are allocated in accordance with subdivision (a) of Section 1 of Article XIII A so as to reduce for any fiscal year the percentage of the total amount of ad valorem property tax revenues in a county that is allocated among all of the local agencies in that county below the percentage of the total amount of those revenues that would be allocated among those agencies for the same fiscal year under the statutes in effect on November 3, 2004. ¶…¶
>
> (2)(A) Except as otherwise provided in subparagraphs (B) and (C), restrict the authority of a city, county, or city and county to impose a tax rate under, or change the method of distributing revenues derived under, the Bradley–Burns Uniform Local Sales and Use Tax Law set forth in Part 1.5 (commencing with

[182] Exhibit X, Voter Information Guide, Supplemental, March 2, 2004 Primary Election.

[183] See Exhibit A, Test Claim, at p. 17.

[184] Exhibit X, Voter Information Guide, Supplemental, November 5, 2004, General Election at p. 6.

> Section 7200) of Division 2 of the Revenue and Taxation Code, as that law read on November 3, 2004. ¶…¶
>
> (3) Except as otherwise provided in subparagraph (C) of paragraph (2), change for any fiscal year the pro rata shares in which ad valorem property tax revenues are allocated among local agencies in a county other than pursuant to a bill passed in each house of the Legislature by roll call vote entered in the journal, two-thirds of the membership concurring.
>
> (4) Extend beyond the revenue exchange period, as defined in Section 7203.1 of the Revenue and Taxation Code as that section read on November 3, 2004, the suspension of the authority, set forth in that section on that date, of a city, county, or city and county to impose a sales and use tax rate under the Bradley–Burns Uniform Local Sales and Use Tax Law.
>
> (5) Reduce, during any period in which the rate authority suspension described in paragraph (4) is operative, the payments to a city, county, or city and county that are required by Section 97.68 of the Revenue and Taxation Code, as that section read on November 3, 2004.
>
> (6) Restrict the authority of a local entity to impose a transactions and use tax rate in accordance with the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251) of Division 2 of the Revenue and Taxation Code), or change the method for distributing revenues derived under a transaction and use tax rate imposed under that law, as it read on November 3, 2004.[185]

This amendment clearly implicates the Triple Flip, imposed by section 97.68, and the suspension of the Sales and Use Tax intended to finance the economic recovery bonds, and prohibits the state from further "modifying" the allocation of ad valorem property tax revenues, thus implicating the ERAF shifts. Furthermore, as noted above, the fact that Proposition 1A was adopted after the test claim statutes does not bar an analysis under section 17556(f).

However, the limitations expressed in Proposition 1A are expressly prospective, and therefore cannot have retroactive effect on the programs and activities imposed by Statutes 2003, chapter 162, Statutes 2004, chapter 211 (SB 1096), and Statutes 2004, chapter 610 (AB 2115), all of which were in effect prior to November 3, 2004. Furthermore, with respect to the analysis under section 17556(f), the test claim statutes creating the Triple Flip and the VLF Swap cannot be said to be expressly included in or necessary to implement Proposition 1A, not least because Proposition 1A is intended specifically and explicitly to *prohibit* future manipulations of local revenue such as those embodied in the test claim statute, on or after November 3, 2004. As discussed, Proposition 1A was meant to curb the Legislature's authority to implement this sort of manipulation of tax revenues *in the future*, and therefore section 17556(f) does not bar reimbursement of the test claim statutes for which mandated activities are found above.

[185] California Constitution, article XIII, section 25.5 (added, Proposition 1A, November 2, 2004, effective November 3, 2004).

c. Proposition 65

Proposition 65 was on the November 2, 2004 ballot as an alternative to Proposition 1A, and was expressly made null and void if Proposition 1A were to pass, which it did. The Voter Information Guide stated as follows:

> Proposition 65 on this ballot contains similar provisions affecting local government finance and mandates. (The nearby box provides information on the major similarities and differences between these measures.) Proposition 1A specifically states that if it and Proposition 65 are approved and Proposition 1A receives more yes votes, none of the provisions of Proposition 65 will go into effect.

None of the provisions of Proposition 65 went into effect, pursuant to the results of the November 2, 2004 election. Only a *voter-enacted* ballot measure requires an analysis under section 17556(f). Therefore section 17556(f) is not applicable.

V. Conclusion

The Commission finds that Revenue and Taxation Code sections 97.71, 97.72, 97.73, 97.70, and 97.68, as added or amended by Statutes 2003, chapter 162 (AB 1766); Statutes 2004, chapter 211 (SB 1096); and Statutes 20004, chapter 610 (AB 2115) and Health and Safety Code sections 33681.12, 33681.13, 33681.14, and 33681.15, as added or amended by Statutes 2004, chapter 211 (SB 1096) and Statutes 2004, chapter 610 (AB 2115), impose a reimbursable state-mandated program within the meaning of article XIII B, section 6 of the California Constitution for the activities listed below:

A. ERAF III Shift

The following requirements of the test claim statutes impose a reimbursable state-mandated program upon all counties beginning in the 2004-2005 fiscal year.

1. ERAF Shift from Counties and Cities

   For 2004-2005 and 2005-2006 fiscal years only:

   a. Reduce revenue otherwise required to be allocated to each county by the amounts listed in Revenue and Taxation Code section 97.71(a)(1), and deposit that amount in the county's ERAF.[186]

   b. Reduce revenue otherwise required to be allocated to a city and county by an amount identified by the Controller pursuant to Revenue and Taxation Code section 97.71(b)(2-3), and deposit that amount in the county's ERAF.[187]

   c. Reduce revenue otherwise required to be allocated to each city within the county by an amount identified by the Controller pursuant to Revenue and Taxation Code section 97.71(b)(2-3), and deposit that amount in the county's ERAF.[188]

[186] Revenue and Taxation Code section 97.71(a)(1); (c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[187] Revenue and Taxation Code section 97.71(b); (c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

Beginning July 1, 2004

a. Where applicable, accept from a city, in lieu of reduction of that city's revenues, an amount equal to the required reduction, and deposit those moneys in the county's ERAF.[189]

Reimbursement is not required for calculating the amounts of revenue otherwise required to be allocated to a city, county, or city and county, which must be reduced and deposited in the county ERAF.[190]

2. ERAF Shift from Special Districts

For fiscal years 2004-2005 and 2005-2006 only:

a. Reduce the amount of ad valorem property tax otherwise required to be allocated to an enterprise special district, including an enterprise special district located in more than one county, in amounts determined by the Controller and received from the Director of Finance, for each enterprise special district in the county.[191]

b. Deposit the amounts reduced from each enterprise special district in the county's ERAF.[192]

c. Reduce the amount of ad valorem property tax otherwise required to be allocated to a nonenterprise special district, including a nonenterprise special district located in more than one county, in amounts determined by the Controller for each special district in each county.[193]

d. Deposit the amounts reduced from each nonenterprise special district in the county's ERAF.[194]

Reimbursement is not required for calculating the amounts of ad valorem property tax otherwise required to be allocated to an enterprise or nonenterprise special district which must be reduced and deposited in the county ERAF.[195]

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[188] Revenue and Taxation Code section 97.71(c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[189] Revenue and Taxation Code section 97.71(b)(5) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[190] Revenue and Taxation Code section 97.71(a)(1); (b)(3) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[191] Revenue and Taxation Code section 97.72(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[192] Revenue and Taxation Code section 97.72(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[193] Revenue and Taxation Code section 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[194] Revenue and Taxation Code section 97.73(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

3. ERAF Shift from Redevelopment Agencies, For fiscal years 2004-2005 and 2005-2006 only:

   a. Receive funds directly from a redevelopment agency in the amount identified by the Director of Finance, and deposit those funds in the county's ERAF.[196]

   b. Receive from the legislative body of the community associated with a redevelopment agency by March 1 of the applicable fiscal year, a report as to how the redevelopment agency intends to secure the funds required to be transferred to the county.[197]

   c. If a redevelopment agency fails to transmit the full amount of funds required by Section 33681.12, is precluded by court order from transmitting that amount, or is otherwise unable to meet its full obligation pursuant to section 33681.12 the county auditor, by no later than May 15 of the applicable fiscal year, shall transfer any amount necessary to meet the obligations determined under section 33681.12 from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95) of the Revenue and Taxation Code.[198]

   d. If the legislative body of the community associated with a redevelopment agency, pursuant to Section 33681.12(d), reported to the county auditor that it intended to remit the amount required on behalf of the redevelopment agency and the legislative body fails to transmit the full amount as authorized by section 33681.12 by May 10 of the applicable fiscal year: the county auditor shall, no later than May 15 of the applicable fiscal year, transfer an amount necessary to meet the redevelopment agency's obligation pursuant to section 33681.12 from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95) of the Revenue and Taxation Code. If the amount of the legislative body's allocations are not sufficient to meet the redevelopment agency's obligation pursuant to section 33681.12, the county auditor shall transfer an additional amount necessary to meet the redevelopment agency's obligation from the property tax increment revenue apportioned to the redevelopment agency pursuant to Section 33670, provided that no moneys allocated to the agency's Low and Moderate Income Housing Fund shall be used for this purpose.[199]

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[195] Revenue and Taxation Code sections 97.72(a)(2); 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[196] Health and Safety Code section 33681.12(a)(1) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[197] Health and Safety Code section 33681.12(d) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[198] Health and Safety Code section 33681.13(e) (added by Stats. 2004, ch. 211 (SB 1096)

[199] Health and Safety Code section 33681.14(c) (added by Stats. 2004, ch. 211 (SB 1096)).

Reimbursement is not required to calculate the amount of moneys to be remitted to the county auditor by a redevelopment agency.[200]

4. ERAF Shift from Redevelopment Agencies, Beginning July 1, 2004:

    a. If a redevelopment agency enters into an agreement with an authorized issuer, as defined, pursuant to section 33681.15, in order to obtain a loan, financed by bonds, to make the payment required by section 33681.12 to the county auditor for deposit in the county's ERAF, the county auditor shall receive a schedule of payments for that loan. And in the event the redevelopment agency fails to timely repay the loan in accordance with the schedule, the county auditor shall receive notification from the trustee for the bonds of the amount that is past due. The county auditor shall then reallocate funds from the legislative body of the community associated with a redevelopment agency and shall pay to the authorized issuer, on behalf of the redevelopment agency, the past due amount on the loan from the first available proceeds of the property tax allocation that would otherwise be transferred to the legislative body pursuant to Chapter 6 (commencing with Section 95) of Part 0.5 of Division 1 of the Revenue and Taxation Code. This transfer shall be deemed a reallocation of the property tax revenue from the legislative body to the agency for the purpose of payment of the loan, and not as a payment by the legislative body on the loan.[201]

B. Vehicle License Fee Swap

The following requirements of the test claim statutes impose a reimbursable state-mandated program upon all counties for the 2004-2005 and 2005-2006 fiscal years, and for the City and County of San Francisco ONLY, in the 2006-2007 fiscal year and after.

1. Establish a Vehicle License Fee Property Tax Compensation Fund in the treasury of the county.[202] This is a one-time activity, by definition.

2. Reduce the total amount of ad valorem property tax otherwise required to be allocated to a county's ERAF by the countywide vehicle license fee adjustment amount.[203]

3. If, after performing the adjustments and allocations required by section 97.68, there is not enough ad valorem property tax revenue that is otherwise required to be allocated to a county ERAF for the auditor to complete the allocation reduction, the auditor shall also reduce the total amount of ad valorem property tax revenue otherwise required to be allocated to all school districts and community college districts in the county, in order to produce the remainder of the countywide vehicle license fee

[200] Health and Safety Code section 33681.12 (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[201] Health and Safety Code section 33681.15(e-g) (added by Stats 2004, ch. 610 (AB 2115)).

[202] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[203] Revenue and Taxation Code section 97.70(a)(1)(A) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

adjustment amount. Reductions to school districts and community college districts shall be made in proportion to each district's share of total ad valorem property tax revenue. School districts and community college districts subject to reductions when ERAF moneys are insufficient shall not include any districts that are excess tax school entities, as defined in Revenue and Taxation Code section 95.[204]

4. Allocate the countywide vehicle license fee adjustment amount to the Vehicle License Fee Property Tax Compensation Fund established in the treasury of each county.[205]

5. Allocate the moneys in the Vehicle License Fee Property Tax Compensation Fund to each city in the county, and to the county or city and county, based on each entity's vehicle license fee adjustment amount.[206] Allocate one-half of the entity's vehicle license fee adjustment amount on or before January 31 of each fiscal year, and the other one-half on or before May 31 of each fiscal year.[207]

6. On or before June 30 of each fiscal year, report to the Controller the vehicle license fee adjustment amount for the county and each city in the county for that fiscal year.[208]

Reimbursement for activities B 1-6 is not required for calculating each entity's vehicle license fee adjustment amount for the 2004-2005 and 2005-2006 fiscal years.[209]

7. For the City and County of San Francisco only: Beginning in the 2006-2007 fiscal year, and continuing thereafter, calculate each entity's vehicle license fee adjustment amount, and the countywide vehicle license fee adjustment amount, defined as the sum of the vehicle license fee adjustment amounts of all entities in the county, pursuant to section 97.70(c)(1)(C).[210]

   This activity includes increasing the prior year's vehicle license fee adjustment amount for each entity based on the percentage change from the prior fiscal year to

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[204] Revenue and Taxation Code section 97.70(a)(1)(B) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[205] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[206] Revenue and Taxation Code section 97.70(b)(1) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[207] Revenue and Taxation Code section 97.70(b)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[208] Revenue and Taxation Code section 97.70(c)(3) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[209] Revenue and Taxation Code section 97.76 (added, Stats. 2004, ch. 211 (SB 1096); amended Stats. 2004, ch. 610 (AB 2115)).

[210] Revenue and Taxation Code section 97.70(c)(1)(C) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)). See also Revenue and Taxation Code section 97.76 (Stats. 2004, ch. 211 (SB 1096)).

the current fiscal year in gross taxable assessed valuation within the jurisdiction of the entity, as reflected in the equalized assessment roll for those fiscal years.

C. Triple Flip

The following requirements of the test claim statutes impose a reimbursable state-mandated program upon all counties for the 2004-2005 and 2005-2006 fiscal years, and for the City and County of San Francisco ONLY, beginning in the 2006-2007 fiscal year.

1. Establish a Sales and Use Tax Compensation Fund in the treasury of the county.[211] This is a one-time activity, by definition.

2. During the fiscal adjustment period, reduce, by the countywide adjustment amount provided by the Department of Finance, the amount otherwise required to be allocated to a county's ERAF, and deposit that amount in the Sales and Use Tax Compensation Fund.[212]

   Reimbursement is not required to calculate the countywide adjustment amount; the amount is annually estimated by the Department of Finance, pursuant to section 97.68(b)(2), except in a fiscal year in which the suspension of 0.25 percent taxing authority is ended, pursuant to Revenue and Taxation Code section 7203.1.

3. During the fiscal adjustment period, allocate revenues in the Sales and Use Tax Compensation Fund among the county and the cities in the county pursuant to the portions of the countywide adjustment amount identified by the Department of Finance for each city and for the county. Allocate one half of the amount identified for each city and for the county in each January during the fiscal adjustment period, and one half the amount identified for each city and for the county in each May during the fiscal adjustment period.[213]

   Reimbursement is not required to calculate the portion of the countywide adjustment amount attributable to the county and each city within the county; the amounts are provided by the Department of Finance, pursuant to section 97.68(c)(1), and recalculated after the end of each fiscal year, pursuant to section 97.68(c)(3), except a fiscal year in which the suspension of 0.25 percent taxing authority is ended, pursuant to Revenue and Taxation Code section 7203.1.

4. If the amount recalculated by the Department of Finance after the end of each fiscal year based on the actual amount of sales and use taxes not transmitted for the prior fiscal year is greater than the amount allocated to a city or to the county based on the portion of the countywide adjustment amount estimated by the Department of

[211] Revenue and Taxation Code section 97.68(a)(2) (Stats.2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[212] Revenue and Taxation Code section 97.68(a-b) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[213] Revenue and Taxation Code section 97.68(c) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

Finance, transfer an amount of ad valorem property tax revenue equal to this difference from the Sales and Use Tax Compensation Fund to that local agency.[214]

5. If the amount recalculated by the Department of Finance after the end of each fiscal year based on the actual amount of sales and use taxes not transmitted for the prior fiscal year is less than the amount allocated to a city or to the county based on the portion of the countywide adjustment amount estimated by the Department of Finance, in the fiscal year following the fiscal year for which the allocation was made, reduce the total amount of ad valorem property tax revenue otherwise allocated to that city or county from the Sales and Use Tax Compensation Fund by an amount equal to this difference and instead allocate this difference to the county ERAF.[215]
6. If there is an insufficient amount of moneys in a county's Sales and Use Tax Compensation Fund to make the necessary transfers, transfer from the county ERAF to the Sales and Use Tax Compensation Fund an amount sufficient to make the full amount of these transfers.[216]
7. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on October 1 of any fiscal year:
    a. Allocate that portion of the countywide adjustment amount attributable to the county and each city within the county on or before January 31 of that fiscal year. The countywide adjustment amount shall be defined as the combined total revenue loss to the county and each city within the county, as estimated by the director of the Department of Finance based on the prior year's *first quarter* sales and use tax revenues transmitted under section 7204; *plus* the difference between 1) the total amount allocated from the Sales and Use Tax Compensation Fund among the county and the cities in the county pursuant to the portions of the countywide adjustment amount identified by the Department of Finance in the prior year; and 2) the actual amount of sales and use tax not transmitted to all entities in the county for the prior year as a result of the 0.25% suspension of local sales and use tax authority.
    b. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.
    c. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not

[214] *Ibid.*

[215] *Ibid.*

[216] *Ibid.*

transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[217]

Reimbursement is not required, under Section 97.68(d)(1), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[218]

8. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on January 1 of any fiscal year:

   a. Allocate that portion of the countywide adjustment amount attributable to the county and each city within the county; one half of the amount on or before January 31 of that fiscal year, and the remaining half of the amount on or before May 31 of that fiscal year. The countywide adjustment amount shall be defined as the combined total revenue loss to the county and each city within the county, as estimated by the director of the Department of Finance based on the sales and use tax revenues transmitted under section 7204 for the *first two quarters* of the prior fiscal year as determined by the Board of Equalization and reported to the director on or before that August 15; *plus* the difference between the total amount allocated to all entities in the county in the prior year and the actual amount of sales and use tax not transmitted to all entities in the county for the prior year.

   b. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

   c. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[219]

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[217] Revenue and Taxation Code section 97.68(d)(1) (Stats. 2004, ch. 211 (SB 1096)).

[218] Revenue and Taxation Code section 97.68(d)(1)(C)(ii) (Stats. 2004, ch. 211 (SB 1096)).

[219] Revenue and Taxation Code section 97.68 (d)(2) (Stats. 2004, ch. 211 (SB 1096)).

Reimbursement is not required, under Section 97.68(d)(2), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[220]

9. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on April 1 of any fiscal year:

   a. Reduce the amount otherwise required to be allocated in May of that fiscal year from the Sales and Use Tax Compensation Fund by the amount reported by director representing that portion of the countywide adjustment amount attributable to the estimated sales and use tax revenue losses resulting from the rate suspension applied by section 7203.1 for the fourth quarter of that fiscal year for the county and each city in the county.

   b. After May allocations have been made, transfer any moneys remaining in the county Sales and Use Tax Compensation Fund to the county ERAF.

   c. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of that fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

   d. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[221]

Reimbursement is not required, under Section 97.68(d)(3), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[222]

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[220] Revenue and Taxation Code section 97.68(d)(2)(C)(ii) (Stats. 2004, ch. 211 (SB 1096)).

[221] Revenue and Taxation Code section 97.68(d)(3) (Stats. 2004, ch. 211 (SB 1096)).

[222] Revenue and Taxation Code section 97.68(d)(3)(C)(ii) (Stats. 2004, ch. 211 (SB 1096)).

10. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on July 1 of any fiscal year:

    a. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of that fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

    b. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts. [223]

    Reimbursement is not required, under Section 97.68(d)(4), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[224]

All other test claim statutes and allegations not specifically approved above do not result in a reimbursable state-mandated program subject to article XIII B, section 6 of the California Constitution and are, therefore, denied.

[223] Revenue and Taxation Code section 97.68(d)(4) (Stats. 2004, ch. 211 (SB 1096)).

[224] Revenue and Taxation Code section 97.68(d)(4)(B)(2) (Stats. 2004, ch. 211 (SB 1096)).

STATE OF CALIFORNIA
COMMISSION ON STATE MANDATES
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RE: **Adopted Statement of Decision**

Local Revenue Realignments, 05-TC-01
Health and Safety Code Section 33681 et al.
County of Los Angeles, Claimant

On September 27, 2013, the foregoing statement of decision of the Commission on State Mandates was adopted in the above-entitled matter.

Dated: October 2, 2013

Heather Halsey, Executive Director

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Solano and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On October 2, 2013, I served the:

Adopted Statement of Decision and Draft Expedited Parameters and Guidelines
Local Revenue Realignments, 05-TC-01
Health and Safety Code Section 33681 et al.
County of Los Angeles, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on October 2, 2013 at Sacramento, California.

Heidi J. Palchik
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

Commission on State Mandates

Original List Date: 8/17/2005
Last Updated: 10/2/2013
List Print Date: 10/02/2013
Claim Number: 05-TC-01
Issue: Accounting for Local Revenue Realignments

Mailing List

TO ALL PARTIES AND INTERESTED PARTIES:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. However, this requirement may also be satisfied by electronically filing your documents. Please see http://www.csm.ca.gov/dropbox.shtml on the Commission's website for instructions on electronic filing. (Cal. Code Regs., tit. 2, § 1181.2.)

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October 2, 2013

Ms. Hasmik Yaghobyan
County of Los Angeles
Auditor-Controller's Office
500 W. Temple Street, Room 603
Los Angeles, CA 90012
And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Adopted Statement of Decision and Draft Expedited Parameters and Guidelines**
Accounting for Local Revenue Realignments, 05-TC-01
Health and Safety Code Section 33681 et al.
County of Los Angeles, Claimant

Dear Ms. Yaghobyan:

On September 27, 2013, the Commission on State Mandates adopted the statement of decision partially approving the above-entitled matter. State law provides that reimbursement, if any, is subject to Commission approval of parameters and guidelines for reimbursement of the mandated program, approval of a statewide cost estimate, a specific legislative appropriation for such purpose, a timely-filed claim for reimbursement, and subsequent review of the claim by the State Controller's Office.

Following is a description of the responsibilities of all parties and of the Commission during the parameters and guidelines phase.

- **Draft Expedited Parameters and Guidelines**. Pursuant to California Code of Regulations, title 2, section 1183.12, the Commission staff is expediting the parameters and guidelines process by enclosing draft parameters and guidelines to assist the claimant. The proposed reimbursable activities are limited to those approved in the statement of decision by the Commission.

- **Claimant's Review of Draft Parameters and Guidelines**. Pursuant to California Code of Regulations, title 2, sections 1183.12(b) and (c), the successful test claimant may file modifications and comments on the proposal with Commission staff by **October 22, 2013**. The claimant may also propose a reasonable reimbursement methodology pursuant to Government Code section 17518.5 and California Code of Regulations, title 2, section 1183.13.

  State Agencies and Interested Parties Comments and Rebuttals. State agencies and interested parties may submit recommendations and comments by **October 17, 2013**. (Cal. Code Regs., tit. 2, § 1183.11(d).) State agencies and interested parties may also submit written rebuttals within 15 days of service of the claimant's modifications and comments. (Cal. Code Regs., tit. 2, § 1183.12(d).)

  Claimant Rebuttals to State Agency and Interested Party Comments. The claimant and other interested parties may submit written rebuttals within 15 days of service of state agency and interested party modifications and comments. (Cal. Code Regs., tit. 2, § 1183.11(f).)

- **Adoption of Parameters and Guidelines**. After review of the draft expedited parameters and guidelines and all proposed modifications and comments, Commission staff will prepare the proposed parameters and guidelines and statement of decision and recommend adoption by the Commission.

Reasonable Reimbursement Methodology and Statewide Estimate of Costs

- **Test Claimant and Department of Finance Submission of Letter of Intent**. Within 30 days of the Commission's adoption of a statement of decision on a test claim, the test claimant(s) and the Department of Finance may notify the executive director of the Commission in writing of their intent to follow the process described in Government Code sections 17557.1–17557.2 and section 1183.30 of the Commission's regulations to develop a *reasonable reimbursement methodology* and *statewide estimate of costs* for the initial claiming period and budget year for reimbursement of costs mandated by the state. The letter of intent shall include the date on which the test claimant and the Department of Finance will submit a plan to ensure that costs from a representative sample of eligible claimants are considered in the development of a reasonable reimbursement methodology.

- **Test Claimant and Department of Finance Submission of Draft Reasonable Reimbursement Methodology and Statewide Estimate of Costs.** Pursuant to the plan, the test claimant and the Department of Finance shall submit the *Draft Reasonable Reimbursement Methodology and Statewide Estimate of Costs* to the Commission. See Government Code section 17557.1 for guidance in preparing and filing a timely submission.

- **Review of Proposed Reasonable Reimbursement Methodology and Statewide Estimate of Costs.** Upon receipt of the jointly developed proposals, Commission staff shall notify all recipients that they shall have the opportunity to review and provide written comments or recommendations concerning the draft reasonable reimbursement methodology and proposed statewide estimate of costs within fifteen (15) days of service. The test claimant and Department of Finance may submit written rebuttals to Commission staff.

- **Adoption of Reasonable Reimbursement Methodology and Statewide Estimate of Costs.** At least ten days prior to the next hearing, Commission staff shall issue review comments and a staff recommendation on whether the Commission should approve the draft reasonable reimbursement methodology and adopt the proposed statewide estimate of costs pursuant to Government Code section 17557.2.

You are advised that comments filed with the Commission are required to be simultaneously served on the other interested parties on the mailing list, and to be accompanied by a proof of service. However, this requirement may also be satisfied by electronically filing your documents. Please see http://www.csm.ca.gov/dropbox.shtml on the Commission's website for instructions on electronic filing. (Cal. Code Regs., tit. 2, § 1181.2.) If you would like to request an extension of time to file comments, please refer to section 1183.01(c)(1) of the Commission's regulations.

The parameters and guidelines are tentatively set for hearing on **January 24, 2014.**

Please contact Heidi Palchik at (916) 323-3562 if you have any questions.

Sincerely,

Heather Halsey
Executive Director

DRAFT EXPEDITED PARAMETERS AND GUIDELINES

Health & Safety Code Sections 33681.12, 33681.13, 33681.14, 33681.15; Revenue & Taxation Code Sections 97.68, 97.70, 97.71, 97.72, 97.73

Statutes 2003, Chapter 162; Statutes 2004, Chapter 211; Statutes 2004, Chapter 610

Accounting for Local Revenue Realignments

05-TC-01

County of Los Angeles, Claimant

I. SUMMARY OF THE MANDATE

On September 27, 2013, the Commission on State Mandates (Commission) adopted a test claim statement of decision finding that the test claim statutes impose a partially reimbursable state-mandated program upon local agencies within the meaning of article XIII B, section 6 of the California Constitution and Government Code section 17514.

The test claim statutes shifted and swapped revenue in three areas: the Educational Revenue Augmentation Fund (ERAF) established by each county; making the Vehicle License Fund (VLF) Swap permanent; and the "triple flip" of sales and use taxes to service debt payments on State Economic Recovery Bonds, "back-filled" from the ERAF, which was in turn replaced by direct subventions from the General Fund. The end result was a savings to the state of $1.3 billion.[1] The three revenue realignment programs created by the test claim statutes imposed reimbursable activities upon counties to establish new accounts within the treasury of the county, and to reduce and reallocate funds as directed by the statutes, and in amounts identified by the Department of Finance or the Controller, respectively. The test claim statutes do not, by the plain language, require counties to calculate, or to verify, the amounts required to be reduced during the 2004-2005 and 2005-2006 fiscal years, but the VLF Swap does require counties to calculate the adjustment amount beginning in the 2006-2007 fiscal year. None of the statutory exclusions from reimbursement found in section 17556 are applicable to these activities in the 2004-2005 and 2005-2006 fiscal years, but beginning in 2006-2007, all counties, except for the City and County of San Francisco, are authorized by Revenue and Taxation Code section 97.75 to charge cities within their jurisdiction fees in an amount sufficient to pay for the administrative costs of the VLF Swap and the Triple Flip required by sections 97.70 and 97.68 of the Revenue and Taxation Code. Therefore, reimbursement for the VLF Swap and Triple Flip must end in the 2006-2007 fiscal year for all counties, except the City and County of San Francisco, because they no longer incur increased costs mandated by the state, by virtue of their authority to charge the incurred costs to cities. However, because the City and County of San Francisco is not relieved of any incurred costs by the operation of the fee authority provided, the City and County continues to be eligible for reimbursement during and after the 2006-2007 fiscal year for the VLF Swap and the Triple Flip.

[1] Exhibit B, Test Claim Volume II, at p. 165 [Committee Analysis of AB 2115].

II. ELIGIBLE CLAIMANTS

Any county, or city and county, which incurs increased costs as a result of this mandate, is eligible to claim reimbursement.

III. PERIOD OF REIMBURSEMENT

Government Code section 17557(e), states that a test claim shall be submitted on or before June 30 following a given fiscal year to establish eligibility for that fiscal year. The County of Los Angeles filed the test claim on August 12, 2005, establishing eligibility for reimbursement for the 2004-2005 fiscal year. Therefore, costs incurred are reimbursable on or after July 1, 2004, or later periods for statutes or amendments enacted after July 1, 2004. Statutes 2003, chapter 162 (AB 1766) has an effective date of August 2, 2003, but does not require any activities until the beginning of fiscal year 2004-2005. Statutes 2004, chapter 211 (SB 1096) has an effective date of August 5, 2004. Statutes 2004, chapter 610 (AB 2115) has an effective date of September 20, 2004.

All activities under Revenue and Taxation Code sections 97.71, 97.72, 97.73, and Health and Safety Code sections 33681.12, 33681.13, and 33681.14 are mandated **only** for the 2004-2005 and 2005-2006 fiscal years, and therefore are no longer reimbursable after June 30, 2006. One remaining activity under Health and Safety Code section 33681.15, as discussed below, may, where applicable, result in state-mandated increased costs other than during fiscal years 2004-2005 and 2005-2006, and therefore may be reimbursable on or after July 1, 2006.

In addition, section 97.75 provides for fee authority for activities mandated by sections 97.68 and 97.70, beginning in fiscal year 2006-2007. Specifically, counties are authorized to charge the administrative costs of the Triple Flip and the VLF swap against their subordinate cities, beginning in fiscal year 2006-2007. The Commission determined in the test claim decision that the fee authority is sufficient to pay for the mandated program, within the meaning of Government Code section 17556(d), for all counties except for the City and County of San Francisco, which cannot, either legally or as a practical matter, avail itself of the fee authority granted. Therefore, the Commission found that reimbursement for the activities required by sections 97.68 and 97.70 ends, for all claimants except the City and County of San Francisco, on June 30, 2006.

The relevant period of reimbursement for each of the activities is specified below under section *IV. Reimbursable Activities*.

Reimbursement for state-mandated costs may be claimed as follows:

1. Actual costs for one fiscal year shall be included in each claim.
2. Pursuant to Government Code section 17561(d)(1)(A), all claims for reimbursement of initial fiscal year costs shall be submitted to the State Controller within 120 days of the issuance date for the claiming instructions.
3. Pursuant to Government Code section 17560(a), a local agency may, by February 15 following the fiscal year in which costs were incurred, file an annual reimbursement claim that details the costs actually incurred for that fiscal year.
4. If revised claiming instructions are issued by the Controller pursuant to Government Code section 17558(c), between November 15 and February 15, a local agency filing an

annual reimbursement claim shall have 120 days following the issuance date of the revised claiming instructions to file a claim. (Government Code section 17560(b).)

5. If the total costs for a given fiscal year do not exceed $1,000, no reimbursement shall be allowed except as otherwise allowed by Government Code section 17564(a).
6. There shall be no reimbursement for any period in which the Legislature has suspended the operation of a mandate pursuant to state law.

IV. REIMBURSABLE ACTIVITIES

To be eligible for mandated cost reimbursement for any fiscal year, only actual costs may be claimed. Actual costs are those costs actually incurred to implement the mandated activities. Actual costs must be traceable and supported by source documents that show the validity of such costs, when they were incurred, and their relationship to the reimbursable activities. A source document is a document created at or near the same time the actual cost was incurred for the event or activity in question. Source documents may include, but are not limited to, employee time records or time logs, sign-in sheets, invoices, and receipts.

Evidence corroborating the source documents may include, but is not limited to, worksheets, cost allocation reports (system generated), purchase orders, contracts, agendas, training packets, and declarations. Declarations must include a certification or declaration stating, "I certify (or declare) under penalty of perjury under the laws of the State of California that the foregoing is true and correct," and must further comply with the requirements of Code of Civil Procedure section 2015.5. Evidence corroborating the source documents may include data relevant to the reimbursable activities otherwise in compliance with local, state, and federal government requirements. However, corroborating documents cannot be substituted for source documents.

The claimant is only allowed to claim and be reimbursed for increased costs for reimbursable activities identified below. Increased cost is limited to the cost of an activity that the claimant is required to incur as a result of the mandate.

For each eligible claimant that incurs increased costs, the following activities are reimbursable:

A. ERAF III Shift

The following requirements of the test claim statutes impose a reimbursable state-mandated program upon all counties beginning in the 2004-2005 fiscal year.

1. ERAF Shift from Counties and Cities

   For 2004-2005 and 2005-2006 fiscal years only, beginning August 5, 2004:

   a. Reduce revenue otherwise required to be allocated to each county by the amounts listed in Revenue and Taxation Code section 97.71(a)(1), and deposit that amount in the county's ERAF.[2]

   b. Reduce revenue otherwise required to be allocated to a city and county by an amount identified by the Controller pursuant to Revenue and Taxation Code section 97.71(b)(2-3), and deposit that amount in the county's ERAF.[3]

[2] Revenue and Taxation Code section 97.71(a)(1); (c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

c. Reduce revenue otherwise required to be allocated to each city within the county by an amount identified by the Controller pursuant to Revenue and Taxation Code section 97.71(b)(2-3), and deposit that amount in the county's ERAF.[4]

d. Where applicable, accept from a city, in lieu of reduction of that city's revenues, an amount equal to the required reduction, and deposit those moneys in the county's ERAF.[5]

Reimbursement is not required for calculating the amounts of revenue otherwise required to be allocated to a city, county, or city and county, which must be reduced and deposited in the county ERAF.[6]

2. ERAF Shift from Special Districts

For fiscal years 2004-2005 and 2005-2006 only, beginning August 5, 2004:

a. Reduce the amount of ad valorem property tax otherwise required to be allocated to an enterprise special district, including an enterprise special district located in more than one county, in amounts determined by the Controller and received from the Director of Finance, for each enterprise special district in the county.[7]

b. Deposit the amounts reduced from each enterprise special district in the county's ERAF.[8]

c. Reduce the amount of ad valorem property tax otherwise required to be allocated to a nonenterprise special district, including a nonenterprise special district located in more than one county, in amounts determined by the Controller for each special district in each county.[9]

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[3] Revenue and Taxation Code section 97.71(b); (c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[4] Revenue and Taxation Code section 97.71(c) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[5] Revenue and Taxation Code section 97.71(b)(5) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[6] Revenue and Taxation Code section 97.71(a)(1); (b)(3) (Stats. 2004, ch. 211 (AB 1096); Stats. 2004, ch. 610 (AB 2115)).

[7] Revenue and Taxation Code section 97.72(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[8] Revenue and Taxation Code section 97.72(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[9] Revenue and Taxation Code section 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

d. Deposit the amounts reduced from each nonenterprise special district in the county's ERAF.[10]

Reimbursement is not required for calculating the amounts of ad valorem property tax otherwise required to be allocated to an enterprise or nonenterprise special district which must be reduced and deposited in the county ERAF.[11]

3. ERAF Shift from Redevelopment Agencies

For fiscal years 2004-2005 and 2005-2006 only, beginning August 5, 2004:

a. Receive funds directly from a redevelopment agency in the amount identified by the Director of Finance, and deposit those funds in the county's ERAF.[12]

b. Receive from the legislative body of the community associated with a redevelopment agency by March 1 of the applicable fiscal year, a report as to how the redevelopment agency intends to secure the funds required to be transferred to the county.[13]

c. If a redevelopment agency fails to transmit the full amount of funds required by Section 33681.12, is precluded by court order from transmitting that amount, or is otherwise unable to meet its full obligation pursuant to section 33681.12 the county auditor, by no later than May 15 of the applicable fiscal year, shall transfer any amount necessary to meet the obligations determined under section 33681.12 from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95) of the Revenue and Taxation Code.[14]

d. If the legislative body of the community associated with a redevelopment agency, pursuant to Section 33681.12(d), reported to the county auditor that it intended to remit the amount required on behalf of the redevelopment agency and the legislative body fails to transmit the full amount as authorized by section 33681.12 by May 10 of the applicable fiscal year: the county auditor shall, no later than May 15 of the applicable fiscal year, transfer an amount necessary to meet the redevelopment agency's obligation pursuant to section 33681.12 from the legislative body's allocations pursuant to Chapter 6 (commencing with Section 95) of the Revenue and Taxation Code. If the amount of the legislative body's allocations are not sufficient to meet the redevelopment agency's obligation pursuant to section 33681.12, the county auditor shall transfer an

[10] Revenue and Taxation Code section 97.73(b) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[11] Revenue and Taxation Code sections 97.72(a)(2); 97.73(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004, ch. 610 (AB 2115)).

[12] Health and Safety Code section 33681.12(a)(1) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[13] Health and Safety Code section 33681.12(d) (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[14] Health and Safety Code section 33681.13(e) (added by Stats. 2004, ch. 211 (SB 1096)

additional amount necessary to meet the redevelopment agency's obligation from the property tax increment revenue apportioned to the redevelopment agency pursuant to Section 33670, provided that no moneys allocated to the agency's Low and Moderate Income Housing Fund shall be used for this purpose.[15]

Reimbursement is not required to calculate the amount of moneys to be remitted to the county auditor by a redevelopment agency.[16]

4. ERAF Shift from Redevelopment Agencies

   Beginning September 20, 2004:

   If a redevelopment agency enters into an agreement with an authorized issuer, as defined, pursuant to section 33681.15, in order to obtain a loan, financed by bonds, to make the payment required by section 33681.12 to the county auditor for deposit in the county's ERAF, the county auditor shall receive a schedule of payments for that loan. And in the event the redevelopment agency fails to timely repay the loan in accordance with the schedule, the county auditor shall receive notification from the trustee for the bonds of the amount that is past due. The county auditor shall then reallocate funds from the legislative body of the community associated with a redevelopment agency and shall pay to the authorized issuer, on behalf of the redevelopment agency, the past due amount on the loan from the first available proceeds of the property tax allocation that would otherwise be transferred to the legislative body pursuant to Chapter 6 (commencing with Section 95) of Part 0.5 of Division 1 of the Revenue and Taxation Code. This transfer shall be deemed a reallocation of the property tax revenue from the legislative body to the agency for the purpose of payment of the loan, and not as a payment by the legislative body on the loan.[17]

B. Vehicle License Fee Swap

The following requirements of the test claim statutes impose a reimbursable state-mandated program upon *all counties for the 2004-2005 and 2005-2006 fiscal years*, beginning August 5, 2004, and for the *City and County of San Francisco ONLY, beginning in the 2006-2007 fiscal year*.

1. Establish a Vehicle License Fee Property Tax Compensation Fund in the treasury of the county.[18] This is a one-time activity, by definition.
2. Reduce the total amount of ad valorem property tax otherwise required to be allocated to a county's ERAF by the countywide vehicle license fee adjustment amount.[19]

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[15] Health and Safety Code section 33681.14(c) (added by Stats. 2004, ch. 211 (SB 1096)).

[16] Health and Safety Code section 33681.12 (added by Stats. 2004, ch. 211 (SB 1096); amended by Stats 2004, ch. 610 (AB 2115)).

[17] Health and Safety Code section 33681.15(e-g) (added by Stats 2004, ch. 610 (AB 2115)).

[18] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

3. If, after performing the adjustments and allocations required by section 97.68, there is not enough ad valorem property tax revenue that is otherwise required to be allocated to a county ERAF for the auditor to complete the allocation reduction, the auditor shall also reduce the total amount of ad valorem property tax revenue otherwise required to be allocated to all school districts and community college districts in the county, in order to produce the remainder of the countywide vehicle license fee adjustment amount. Reductions to school districts and community college districts shall be made in proportion to each district's share of total ad valorem property tax revenue. School districts and community college districts subject to reductions when ERAF moneys are insufficient shall not include any districts that are excess tax school entities, as defined in Revenue and Taxation Code section 95.[20]

4. Allocate the countywide vehicle license fee adjustment amount to the Vehicle License Fee Property Tax Compensation Fund established in the treasury of each county.[21]

5. Allocate the moneys in the Vehicle License Fee Property Tax Compensation Fund to each city in the county, and to the county or city and county, based on each entity's vehicle license fee adjustment amount.[22] Allocate one-half of the entity's vehicle license fee adjustment amount on or before January 31 of each fiscal year, and the other one-half on or before May 31 of each fiscal year.[23]

6. On or before June 30 of each fiscal year, report to the Controller the vehicle license fee adjustment amount for the county and each city in the county for that fiscal year.[24]

Reimbursement for activities B 1-6 is not required for calculating each entity's vehicle license fee adjustment amount for the 2004-2005 and 2005-2006 fiscal years.[25]

7. For the City and County of San Francisco only: Beginning in the 2006-2007 fiscal year calculate each entity's vehicle license fee adjustment amount, and the countywide vehicle license fee adjustment amount, defined as the sum of the vehicle

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[19] Revenue and Taxation Code section 97.70(a)(1)(A) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[20] Revenue and Taxation Code section 97.70(a)(1)(B) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[21] Revenue and Taxation Code section 97.70(a)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[22] Revenue and Taxation Code section 97.70(b)(1) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[23] Revenue and Taxation Code section 97.70(b)(2) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[24] Revenue and Taxation Code section 97.70(c)(3) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)).

[25] Revenue and Taxation Code section 97.76 (added, Stats. 2004, ch. 211 (SB 1096); amended Stats. 2004, ch. 610 (AB 2115)).

license fee adjustment amounts of all entities in the county, pursuant to section 97.70(c)(1)(C).[26]

This activity includes increasing the prior year's vehicle license fee adjustment amount for each entity based on the percentage change from the prior fiscal year to the current fiscal year in gross taxable assessed valuation within the jurisdiction of the entity, as reflected in the equalized assessment roll for those fiscal years.

C. Triple Flip

The following requirements of the test claim statutes impose a reimbursable state-mandated program upon *all counties for the 2004-2005 and 2005-2006 fiscal years*, and for the *City and County of San Francisco ONLY, beginning in the 2006-2007 fiscal year*.

1. Establish a Sales and Use Tax Compensation Fund in the treasury of the county.[27] This is a one-time activity, by definition.

2. During the fiscal adjustment period, reduce, by the countywide adjustment amount provided by the Department of Finance, the amount otherwise required to be allocated to a county's ERAF, and deposit that amount in the Sales and Use Tax Compensation Fund.[28]

   Reimbursement is not required to calculate the countywide adjustment amount; the amount is annually estimated by the Department of Finance, pursuant to section 97.68(b)(2), except in a fiscal year in which the suspension of 0.25 percent taxing authority is ended, pursuant to Revenue and Taxation Code section 7203.1.

3. During the fiscal adjustment period, allocate revenues in the Sales and Use Tax Compensation Fund among the county and the cities in the county pursuant to the portions of the countywide adjustment amount identified by the Department of Finance for each city and for the county. Allocate one half of the amount identified for each city and for the county in each January during the fiscal adjustment period, and one half the amount identified for each city and for the county in each May during the fiscal adjustment period.[29]

   Reimbursement is not required to calculate the portion of the countywide adjustment amount attributable to the county and each city within the county; the amounts are provided by the Department of Finance, pursuant to section 97.68(c)(1), and recalculated after the end of each fiscal year, pursuant to section 97.68(c)(3),

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[26] Revenue and Taxation Code section 97.70(c)(1)(C) (Stats. 2004, ch. 211 (SB 1096); Stats. 2004 ch. 610 (AB 2115)). See also Revenue and Taxation Code section 97.76 (Stats. 2004, ch. 211 (SB 1096)).

[27] Revenue and Taxation Code section 97.68(a)(2) (Stats.2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[28] Revenue and Taxation Code section 97.68(a-b) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

[29] Revenue and Taxation Code section 97.68(c) (Stats. 2003, ch. 162 (AB 1766); Stats. 2004, ch. 211 (SB 1096)).

except a fiscal year in which the suspension of 0.25 percent taxing authority is ended, pursuant to Revenue and Taxation Code section 7203.1.

4. If the amount recalculated by the Department of Finance after the end of each fiscal year based on the actual amount of sales and use taxes not transmitted for the prior fiscal year is greater than the amount allocated to a city or to the county based on the portion of the countywide adjustment amount estimated by the Department of Finance, transfer an amount of ad valorem property tax revenue equal to this difference from the Sales and Use Tax Compensation Fund to that local agency.[30]

5. If the amount recalculated by the Department of Finance after the end of each fiscal year based on the actual amount of sales and use taxes not transmitted for the prior fiscal year is less than the amount allocated to a city or to the county based on the portion of the countywide adjustment amount estimated by the Department of Finance, in the fiscal year following the fiscal year for which the allocation was made, reduce the total amount of ad valorem property tax revenue otherwise allocated to that city or county from the Sales and Use Tax Compensation Fund by an amount equal to this difference and instead allocate this difference to the county ERAF.[31]

6. If there is an insufficient amount of moneys in a county's Sales and Use Tax Compensation Fund to make the necessary transfers, transfer from the county ERAF to the Sales and Use Tax Compensation Fund an amount sufficient to make the full amount of these transfers.[32]

7. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on October 1 of any fiscal year:

    a. Allocate that portion of the countywide adjustment amount attributable to the county and each city within the county on or before January 31 of that fiscal year. The countywide adjustment amount shall be defined as the combined total revenue loss to the county and each city within the county, as estimated by the director of the Department of Finance based on the prior year's *first quarter* sales and use tax revenues transmitted under section 7204; *plus* the difference between 1) the total amount allocated from the Sales and Use Tax Compensation Fund among the county and the cities in the county pursuant to the portions of the countywide adjustment amount identified by the Department of Finance in the prior year; and 2) the actual amount of sales and use tax not transmitted to all entities in the county for the prior year as a result of the 0.25% suspension of local sales and use tax authority.

    b. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25

[30] *Ibid.*

[31] *Ibid.*

[32] *Ibid.*

percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

c. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[33]

Reimbursement is not required, under Section 97.68(d)(1), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[34]

8. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on January 1 of any fiscal year:

   a. Allocate that portion of the countywide adjustment amount attributable to the county and each city within the county; one half of the amount on or before January 31 of that fiscal year, and the remaining half of the amount on or before May 31 of that fiscal year. The countywide adjustment amount shall be defined as the combined total revenue loss to the county and each city within the county, as estimated by the director of the Department of Finance based on the sales and use tax revenues transmitted under section 7204 for the *first two quarters* of the prior fiscal year as determined by the Board of Equalization and reported to the director on or before that August 15; *plus* the difference between the total amount allocated to all entities in the county in the prior year and the actual amount of sales and use tax not transmitted to all entities in the county for the prior year.

   b. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

   c. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not

[33] Revenue and Taxation Code section 97.68(d)(1) (Stats. 2004, ch. 211 (SB 1096)).

[34] Revenue and Taxation Code section 97.68(d)(1)(C)(ii) (Stats. 2004, ch. 211 (SB 1096)).

transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[35]

Reimbursement is not required, under Section 97.68(d)(2), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[36]

9. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on April 1 of any fiscal year:

   a. Reduce the amount otherwise required to be allocated in May of that fiscal year from the Sales and Use Tax Compensation Fund by the amount reported by director representing that portion of the countywide adjustment amount attributable to the estimated sales and use tax revenue losses resulting from the rate suspension applied by section 7203.1 for the fourth quarter of that fiscal year for the county and each city in the county.

   b. After May allocations have been made, transfer any moneys remaining in the county Sales and Use Tax Compensation Fund to the county ERAF.

   c. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of that fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

   d. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts.[37]

   Reimbursement is not required, under Section 97.68(d)(3), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts

[35] Revenue and Taxation Code section 97.68 (d)(2) (Stats. 2004, ch. 211 (SB 1096)).

[36] Revenue and Taxation Code section 97.68(d)(2)(C)(ii) (Stats. 2004, ch. 211 (SB 1096)).

[37] Revenue and Taxation Code section 97.68(d)(3) (Stats. 2004, ch. 211 (SB 1096)).

allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[38]

10. If the suspension of sales and use tax authority under section 7203.1 ceases to be operative on July 1 of any fiscal year:

    a. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is greater than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of that fiscal year, reallocate from the entity to the county ERAF the difference between those amounts.

    b. If, for any county or city, the portion of the countywide adjustment amount allocated to that entity from the Sales and Use Tax Compensation Fund is less than the actual total amount of local sales and use tax revenue that was not transmitted to the entity for the prior fiscal year as a result of the 0.25 percent suspension of local sales and use tax authority applied by Section 7203.1, on or before January 31 of the following fiscal year, reallocate from the county ERAF to that entity the difference between those amounts. [39]

    Reimbursement is not required, under Section 97.68(d)(4), to calculate or identify countywide adjustment amount, or the portion attributable to the county and to each city within the county, or the difference between the countywide adjustment amounts allocated to the county and to each city and the actual sales and use tax revenues not transmitted to the county and to each city as a result of the suspension of sales and use tax authority; the county auditor shall be notified of those amounts by the director of the Department of Finance.[40]

All other test claim statutes and allegations not specifically approved above do not result in a reimbursable state-mandated program subject to article XIII B, section 6 of the California Constitution and are, therefore, denied.

V. CLAIM PREPARATION AND SUBMISSION

Each of the following cost elements must be identified for each reimbursable activity identified in Section IV, Reimbursable Activities, of this document. Each claimed reimbursable cost must be supported by source documentation as described in Section IV. Additionally, each reimbursement claim must be filed in a timely manner.

[38] Revenue and Taxation Code section 97.68(d)(3)(C)(ii) (Stats. 2004, ch. 211 (SB 1096)).

[39] Revenue and Taxation Code section 97.68(d)(4) (Stats. 2004, ch. 211 (SB 1096)).

[40] Revenue and Taxation Code section 97.68(d)(4)(B)(2) (Stats. 2004, ch. 211 (SB 1096)).

A. Direct Cost Reporting

Direct costs are those costs incurred specifically for the reimbursable activities. The following direct costs are eligible for reimbursement.

1. Salaries and Benefits

Report each employee implementing the reimbursable activities by name, job classification, and productive hourly rate (total wages and related benefits divided by productive hours). Describe the specific reimbursable activities performed and the hours devoted to each reimbursable activity performed.

2. Materials and Supplies

Report the cost of materials and supplies that have been consumed or expended for the purpose of the reimbursable activities. Purchases shall be claimed at the actual price after deducting discounts, rebates, and allowances received by the claimant. Supplies that are withdrawn from inventory shall be charged on an appropriate and recognized method of costing, consistently applied.

3. Contracted Services

Report the name of the contractor and services performed to implement the reimbursable activities. If the contractor bills for time and materials, report the number of hours spent on the activities and all costs charged. If the contract is a fixed price, report the services that were performed during the period covered by the reimbursement claim. If the contract services are also used for purposes other than the reimbursable activities, only the pro-rata portion of the services used to implement the reimbursable activities can be claimed. Submit contract consultant and attorney invoices with the claim and a description of the contract scope of services.

4. Fixed Assets

Report the purchase price paid for fixed assets (including computers) necessary to implement the reimbursable activities. The purchase price includes taxes, delivery costs, and installation costs. If the fixed asset is also used for purposes other than the reimbursable activities, only the pro-rata portion of the purchase price used to implement the reimbursable activities can be claimed.

5. Travel

Report the name of the employee traveling for the purpose of the reimbursable activities. Include the date of travel, destination, the specific reimbursable activity requiring travel, and related travel expenses reimbursed to the employee in compliance with the rules of the local jurisdiction. Report employee travel time according to the rules of cost element A.1., Salaries and Benefits, for each applicable reimbursable activity.

B. Indirect Cost Rates

Indirect costs are costs that are incurred for a common or joint purpose, benefiting more than one program, and are not directly assignable to a particular department or program without efforts disproportionate to the result achieved. Indirect costs may include both: (1) overhead costs of the unit performing the mandate; and (2) the costs of the central government services distributed to the other departments based on a systematic and rational basis through a cost allocation plan.

Compensation for indirect costs is eligible for reimbursement utilizing the procedure provided in 2 CFR Part 225 (Office of Management and Budget (OMB) Circular A-87). Claimants have the option of using 10% of direct labor, excluding fringe benefits, or preparing an Indirect Cost Rate Proposal (ICRP) if the indirect cost rate claimed exceeds 10%.

If the claimant chooses to prepare an ICRP, both the direct costs (as defined and described in 2 CFR Part 225, Appendix A and B (OMB Circular A-87 Attachments A and B) and the indirect costs shall exclude capital expenditures and unallowable costs (as defined and described in 2 CFR Part 225, Appendix A and B (OMB Circular A-87 Attachments A and B). However, unallowable costs must be included in the direct costs if they represent activities to which indirect costs are properly allocable.

The distribution base may be: (1) total direct costs (excluding capital expenditures and other distorting items, such as pass-through funds, major subcontracts, etc.); (2) direct salaries and wages; or (3) another base which results in an equitable distribution.

In calculating an ICRP, the claimant shall have the choice of one of the following methodologies:

1. The allocation of allowable indirect costs (as defined and described in OMB Circular A-87 Attachments A and B) shall be accomplished by: (1) classifying a department's total costs for the base period as either direct or indirect; and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to mandates. The rate should be expressed as a percentage which the total amount of allowable indirect costs bears to the base selected; or
2. The allocation of allowable indirect costs (as defined and described in OMB Circular A-87 Attachments A and B) shall be accomplished by: (1) separating a department into groups, such as divisions or sections, and then classifying the division's or section's total costs for the base period as either direct or indirect; and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate that is used to distribute indirect costs to mandates. The rate should be expressed as a percentage which the total amount of allowable indirect costs bears to the base selected.

VI. RECORD RETENTION

Pursuant to Government Code section 17558.5(a), a reimbursement claim for actual costs filed by a local agency or school district pursuant to this chapter[41] is subject to the initiation of an audit by the Controller no later than three years after the date that the actual reimbursement claim is filed or last amended, whichever is later. However, if no funds are appropriated or no payment is made to a claimant for the program for the fiscal year for which the claim is filed, the time for the Controller to initiate an audit shall commence to run from the date of initial payment of the claim. In any case, an audit shall be completed not later than two years after the date that the audit is commenced. All documents used to support the reimbursable activities, as described in Section IV, must be retained during the period subject to audit. If an audit has been initiated by

[41] This refers to Title 2, division 4, part 7, chapter 4 of the Government Code.

the Controller during the period subject to audit, the retention period is extended until the ultimate resolution of any audit findings.

VII. OFFSETTING REVENUES AND REIMBURSEMENTS

Any offsetting revenue the claimant experiences in the same program as a result of the same statutes or executive orders found to contain the mandate shall be deducted from the costs claimed. In addition, reimbursement for this mandate from any source, including but not limited to, service fees collected, federal funds, and other state funds, shall be identified and deducted from this claim.

VIII. STATE CONTROLLER'S CLAIMING INSTRUCTIONS

Pursuant to Government Code section 17558(b), the Controller shall issue claiming instructions for each mandate that requires state reimbursement not later than 90 days after receiving the adopted parameters and guidelines from the Commission, to assist local agencies and school districts in claiming costs to be reimbursed. The claiming instructions shall be derived from the test claim decision and the parameters and guidelines adopted by the Commission.

Pursuant to Government Code section 17561(d)(1), issuance of the claiming instructions shall constitute a notice of the right of the local agencies and school districts to file reimbursement claims, based upon parameters and guidelines adopted by the Commission.

IX. REMEDIES BEFORE THE COMMISSION

Upon request of a local agency or school district, the Commission shall review the claiming instructions issued by the State Controller or any other authorized state agency for reimbursement of mandated costs pursuant to Government Code section 17571. If the Commission determines that the claiming instructions do not conform to the parameters and guidelines, the Commission shall direct the Controller to modify the claiming instructions and the Controller shall modify the claiming instructions to conform to the parameters and guidelines as directed by the Commission.

In addition, requests may be made to amend parameters and guidelines pursuant to Government Code section 17557(d), and California Code of Regulations, title 2, section 1183.2.

X. LEGAL AND FACTUAL BASIS FOR THE PARAMETERS AND GUIDELINES

The statements of decision adopted for the test claim and parameters and guidelines are legally binding on all parties and provide the legal and factual basis for the parameters and guidelines. The support for the legal and factual findings is found in the administrative record. The administrative record is on file with the Commission.

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Solano and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On October 2, 2013, I served the:

Adopted Statement of Decision and Draft Expedited Parameters and Guidelines
Local Revenue Realignments, 05-TC-01
Health and Safety Code Section 33681 et al.
County of Los Angeles, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on October 2, 2013 at Sacramento, California.

Heidi J. Palchik
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

Commission on State Mandates

Original List Date: 8/17/2005
Last Updated: 10/2/2013
List Print Date: 10/02/2013
Claim Number: 05-TC-01
Issue: Accounting for Local Revenue Realignments

Mailing List

TO ALL PARTIES AND INTERESTED PARTIES:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. However, this requirement may also be satisfied by electronically filing your documents. Please see http://www.csm.ca.gov/dropbox.shtml on the Commission's website for instructions on electronic filing. (Cal. Code Regs., tit. 2, § 1181.2.)

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JOHN CHIANG
California State Controller
Division of Accounting and Reporting

October 17, 2013

Ms. Heather Halsey
Executive Director
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814

Re: Adopted Statement of Decision and Draft Expedited Parameters and Guidelines
Accounting for Local Revenue Realignments, 05-TC-01
Health and Safety Code Section 33681 et al.
County of Los Angeles, Claimant

Dear Ms. Halsey:

The State Controller's Office has reviewed the draft expedited parameters and guidelines submitted by the Commission.

Under Section C. Triple Flip, numbers 7 through 10, there needs to be clarification for the effective start date. By not including Stats. 2003, ch. 162 (AB 1766) in the footnotes, the effective start date would be August 5, 2004. If you include Stats. 2003, ch. 162 (AB 1766) in the footnotes, the reimbursement start date would be July 1, 2004.

Should you have any questions regarding the above, please contact Ron Vogel at (916) 323-0698 or e-mail rvogel@sco.ca.gov.

Sincerely,

JAY LAL, Manager
Local Reimbursements Section

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Solano and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On October 18, 2013, I served the:

State Controller's Office Comments
Local Revenue Realignments, 05-TC-01
Health and Safety Code Section 33681 et al.
County of Los Angeles, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on October 18, 2013 at Sacramento, California.

Lorenzo Duran Jr.
Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814
(916) 323-3562

Original List Date: 8/17/2005
Last Updated: 10/18/2013
List Print Date: 10/18/2013
Claim Number: 05-TC-01
Issue: Accounting for Local Revenue Realignments

Mailing List

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LAO

Insufficient ERAF:

Examining A Recent Issue in Local Government Finance

MAC TAYLOR • LEGISLATIVE ANALYST • DECEMBER 18, 2012

Summary

Over the last two years, a small number of cities and counties did not receive enough local property tax revenue to offset two complex state-local financial transactions: the triple flip and vehicle license fee (VLF) swap. This funding insufficiency, commonly called "insufficient ERAF" (Educational Revenue Augmentation Fund), requires state action if the affected local governments are to receive complete payment. To assist the Legislature in responding to this unanticipated development, this report describes the causes of insufficient ERAF and outlines a framework the Legislature may wish to use in considering remedies. We summarize the highlights of our report below.

Insufficient ERAF Probably Is a Limited Issue. To date, insufficient ERAF has affected local governments in only two counties—Amador and San Mateo—and resulted in total VLF swap funding shortfalls of less than $2 million. Insufficient ERAF may grow somewhat over the next few years. In the longer term, however, insufficient ERAF likely will be limited to a small number of cities and counties—or not occur at all in some years.

Two Possible Levels of Compensation for Insufficient ERAF Appear Reasonable. As insufficient ERAF is not the product of any particular local government actions, a strong analytical argument can be made that the state should reimburse cities and counties for *all* triple flip and VLF swap funding shortfalls. This would require increased state expenditures, potentially up to tens of millions of dollars annually. On the other hand, in recognition of the significant fiscal benefits cities and counties receive under the VLF swap, the Legislature may wish to reimburse cities and counties only where necessary to replace actual sales tax and VLF revenue losses.

Compensation Mechanisms Are Limited. We see two primary options for compensating local governments experiencing insufficient ERAF: provide the compensation in the annual state budget or through a redirection of certain local education agency property tax revenues.

INTRODUCTION

Almost a decade ago, the Legislature adopted two complex financial transactions with California's cities and counties known as the "triple flip" and "VLF swap." Under these transactions, city and county sales tax and VLF revenues are reduced, but local revenue shortfalls are offset annually by property taxes redirected from (1) a countywide educational account (ERAF) and, in some cases, (2) certain K-12 and community college districts. Local education district revenue losses, in turn, are offset by increased state aid.

Earlier this year, the auditor from Amador County reported an unanticipated development: available funding in 2010-11 was not sufficient to fully reimburse the second financial transaction, the VLF swap. The county had insufficient ERAF—not enough revenues to fully compensate local governments for the triple flip and/or VLF swap. More recently, county auditors reported that insufficient ERAF continued in Amador County in 2011-12 and expanded to include local governments in San Mateo County.

In the 2012-13 state budget, the Legislature appropriated $1.5 million to fully offset Amador County's 2010-11 funding shortfall. (Funding insufficiencies in Amador and San Mateo in 2011-12 were not known until after the state budget was adopted.) To consider the state's options for addressing future claims of insufficient ERAF, the *Supplemental Report of the 2012-13 Budget Package* directed the Legislative Analyst's Office and the Department of Finance (DOF) to submit reports (1) addressing the conditions under which local governments may be compensated in cases where there are insufficient local funds to offset fully the fiscal effect of the triple flip and VLF Swap and (2) outlining one or more alternative mechanisms for providing such compensation. This report is submitted in fulfillment of our office's requirement.

BACKGROUND

In order to better comprehend the complicated issue of insufficient ERAF, this report begins with an overview of California's system of distributing property taxes amongst local governments. It then describes several major statutory measures that are integral to the issue of insufficient ERAF: the 1990s ERAF property tax shift, triple flip, VLF swap, and dissolution of redevelopment.

Property Tax Allocations Basics

Property Taxes Are Shared by Many Local Governments. All property tax revenue remains within the county in which it is collected to be used exclusively by local governments (cities, counties, special districts, K-12 schools, and community college districts). The county auditor is responsible for allocating revenue generated from the 1 percent rate to local governments pursuant to state law. The allocation system commonly is 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 tax revenue collected within a community to each local government that provides services within the community.

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 because of the state's education finance system under which the state guarantees each school district an overall level of funding. For K-12 districts, each district receives a comparable amount of per-pupil 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. 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. Conversely, if a district's nonstate resources alone exceed the district's revenue limit or apportionment funding level, the district does not receive general purpose state aid (though they typically receive funding for various categorical programs). These districts commonly are referred to as "basic aid" districts because historically they have received only the minimum amount of state aid required by the State Constitution (known as basic aid).

Each year, the state estimates how much each district will receive in local property tax revenue (and student fee revenue in the case of community colleges), then the annual budget act appropriates state General Fund to "make up the difference" and fund the district's revenue limit or apportionment at the intended level. Frequently, however, the actual property tax revenues allocated to school districts may be less than anticipated. The state's education finance system addresses these shortfalls differently for different types of educational entities. For K-12 districts, all funding shortfalls are backfilled automatically with additional state aid. In contrast, explicit state action is required to backfill community college funding shortfalls.

1990s ERAF Property Tax Shift

Property Taxes Shifted to Schools. In 1992-93 and 1993-94, in response to serious budgetary shortfalls, the state permanently redirected almost one-fifth of total statewide property tax revenue from cities, counties, and special districts to K-12 and community college districts. Under the changes in property tax allocation laws, the redirected property tax revenue is deposited into a countywide fund for schools, ERAF. The property tax revenue from ERAF is distributed to nonbasic aid schools and community colleges, reducing the state's funding obligations for K-14 education.

"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-12 and community college 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 they contributed to ERAF. The ERAF funds that are returned to noneducational local governments are known as excess ERAF.

Triple Flip

The Triple Flip Is Reimbursed From ERAF. 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.

- K-12 and community college district tax losses from the redirection of ERAF to cities and counties, in turn, are offset by increased state aid.

Triple Flip Projected to End in 2016-17. Based on current projections, the Proposition 57 deficit-financing bond will be repaid in 2016-17 and the triple flip will be ended. At that time, the $1.7 billion in ERAF monies that otherwise would have been used to fund the triple flip will be available for other uses—namely funding the VLF swap and offsetting state K-14 expenditures.

VLF Swap

VLF Traditionally Has Been a Local Revenue Source. Established in 1935, the VLF is an annual tax on the ownership of registered vehicles in California in place of taxing vehicles as personal property. The tax is based on the vehicle's purchase price and declines in accordance with a statutory depreciation schedule. For most of its years, the primary use of VLF has been as a general purpose local government revenue source—with all or most VLF revenues distributed to cities and counties on a per capita basis.

State Began Reducing VLF Revenue Collections in the Late 1990s. While the VLF rate was 2 percent for over five decades, the state began enacting measures in 1999 that reduced the effective VLF rate paid by vehicle owners—thus reducing revenue collections. Most notably, Chapter 322, Statutes of 1998 (AB 2797, Cardoza), established an "offset" to the annual VLF paid by vehicle owners. Under this legislation, the VLF owed by a vehicle owner was initially calculated using the 2 percent tax rate and then the offset was applied, effectively reducing the rate paid by the vehicle owner. The amount of the tax reduction was shown as a credit on the vehicle owner's registration bill. Beginning in 1999, this offset acted to reduce VLF collections by 25 percent. Chapter 322 provided for a series of additional reductions beginning in 2001, possibly reaching a maximum 67.5 percent beginning in 2003, if General Fund revenue growth met certain targets. Subsequent legislation accelerated the pace of these additional effective rate reductions, setting the VLF offset at 67.5 percent and reducing VLF collections a commensurate amount. Under this reduction, the effective VLF rate paid by vehicle owners was 0.65 percent.

State General Fund Allocations Backfilled Local Revenue Losses. These reductions in VLF collections substantially reduced the revenue available for cities and counties. The Legislature, however, replaced the lost VLF revenues with General Fund allocations to cities and counties on a dollar-for-dollar basis. Funds from the General Fund backfill generally were allocated on a per capita basis so that each city and county received the same amount of revenue as the local government would have received absent the VLF reductions. The backfill was continuously appropriated and, therefore, not subject to annual appropriation in the budget bill.

General Fund Resources Found Insufficient to Cover Backfill. Chapter 322 included a "trigger" provision requiring the effective VLF rate to be increased during periods in which insufficient General Fund monies were available to backfill for city and county revenue losses. In these cases, General Fund expenditures for the backfill would be reduced, accompanied by a commensurate increase in VLF payments made by vehicle owners. In June 2003, Governor Davis determined that there were insufficient funds for the state to continue making backfill payments to cities and counties. As a result, backfill payments were suspended in June 2003. For various reasons, however, the effective VLF rate was not returned to 2 percent until October 2003. Following the

recall election, in November 2003 Governor Schwarzenegger reversed the determination of insufficiency. This restored the effective VLF rate to 0.65 percent and resumed payment of the General Fund backfill to cities and counties. The time difference between the suspension of the backfill payments and the increase in the effective VLF rate resulted in revenue losses of $1.3 billion for cities and counties. This amount was deemed to be a loan from cities and counties to the state, and was repaid during the 2005-06 budget year.

VLF Swap Enacted to Replace General Fund Backfill. In 2004, the state and cities and counties worked together to develop a new mechanism for reimbursing cities and counties for their reduced VLF revenue. This mechanism, known as the VLF swap, provides an element of increased security for cities and counties by replacing a state-controlled reimbursement with a revenue source that is subject to greater local control. Specifically, the VLF swap replaced the General Fund VLF backfill with property taxes redirected at the county level from (1) ERAF and, if ERAF revenues are not sufficient, from (2) nonbasic aid K-12 and community college districts. (All reductions in revenue to K-12 and community college districts are offset by additional state aid.) The VLF swap also specified that future growth in these reimbursement property taxes would not be distributed on a per capita basis (like VLF revenues and the VLF General Fund backfill had been). Instead, the property taxes provided as part of the VLF swap would grow each year based on growth in property values within the entity.

Redevelopment Dissolution

Dissolution of Redevelopment Increases Property Taxes Distributed to Schools. The 2011-12 budget package included legislation—Chapter 5 (ABX1 26, Blumenfield)—that resulted in the dissolution of all redevelopment agencies (RDAs) in California effective February 2012. As discussed in our report, *The 2012-13 Budget: Unwinding Redevelopment*, by diverting property taxes from K-12 and community college districts, redevelopment had the overall effect of increasing state costs for K-14 education. Under the dissolution process, the property tax revenue that formerly went to RDAs is used first to pay off redevelopment debts and obligations and the remainder is distributed to local governments, including K-12 and community college districts, in accordance with AB 8. The shift of property taxes to nonbasic aid districts reduces state K-14 expenditures by a similar amount. Over time, as former redevelopment debts and obligations are retired, state savings from redevelopment dissolution will grow as school districts receive larger distributions of property taxes. The cash and other liquid assets of former RDAs also will be distributed to local governments in accordance with AB 8. These distributions will provide additional one-time increases in revenue for school districts in the current year and over the next few years.

No Change in Excess ERAF. In general, an increase in the amount of property tax revenue to school districts decreases (1) the amount of state funding needed by schools to reach their revenue limits and (2) the amount of ERAF that can be used to offset the state's obligations. As less ERAF funding is needed to offset state education expenditures, more property tax is returned to local governments as excess ERAF. This, in turn, leaves fewer resources in ERAF available to make payments under the triple flip and VLF swap. In order to maximize the state's fiscal benefit from the dissolution of redevelopment, the Legislature enacted Chapter 26, Statutes of 2012 (AB 1484, Committee on Budget), which directs county auditors to exclude revenues provided to schools by the dissolution of RDAs in the calculation of excess ERAF.

ADMINISTERING THE TRIPLE FLIP AND VLF SWAP

Calculating Payments to Cities and Counties

Triple Flip Reimbursements Equal to Projected Annual Reductions in Sales Tax Revenue. Each fiscal year, DOF provides county auditors with an estimate of the sales tax revenue lost by each local government as a result of the triple flip. The DOF's estimate is based on the actual amount of sales tax revenue distributed to each local government in the prior year, adjusted for projected growth (as determined by the State Board of Equalization) in the current year.

VLF Swap Payments Pegged to Growth in Local Assessed Property Values. In general, each city and county's annual VLF payment is equal to its VLF losses related to the state reductions in 2004-05, grown by the total percentage change in the city or county's assessed value of taxable property—or assessed valuation—between 2004-05 and the current year. For example, if a city's VLF revenue losses were $1 million in 2004-05 and its assessed valuation increased by 20 percent between 2004-05 and 2012-13, then its VLF payment in 2012-13 is $1.2 million. For the purposes of this calculation, county auditors are directed to ignore any growth in assessed valuation due to changes in a city's boundaries, such as an expansion of boundaries through annexation, that occur after 2004-05.

Reimbursement Process

Figure 1 (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 shortfalls are referred to as insufficient ERAF. The major steps in the process are as follows.

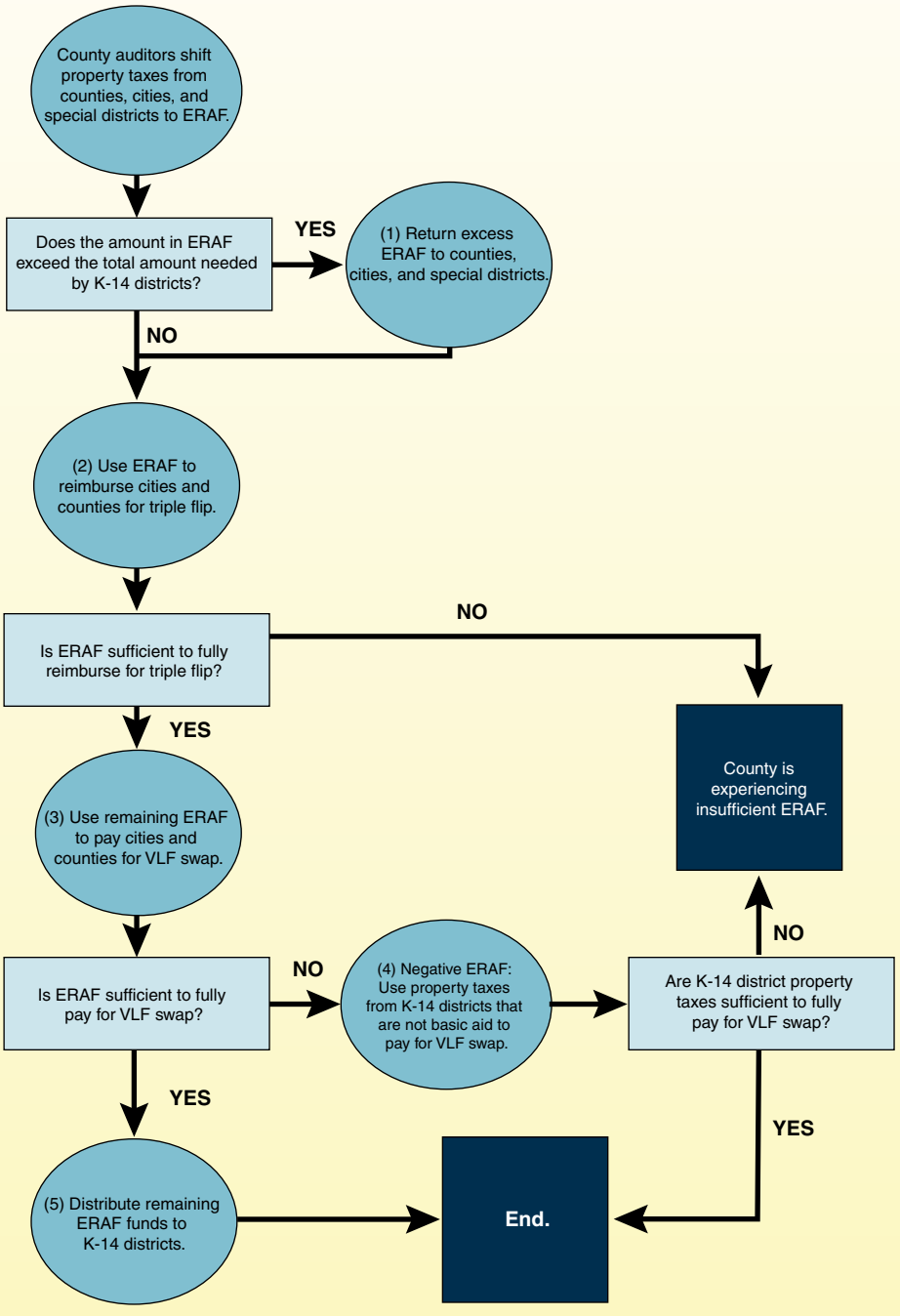
Step 1: Return Excess ERAF. As shown in the figure, the first step is for each county auditor to determine whether the funds deposited into the countywide account exceed the amount needed by all nonbasic aid K-12 and community college districts in the county, plus a specified amount for special education. If so, the special education program receives funding from ERAF and any remaining 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 recently modified to exclude property taxes distributed to K-12 and community college districts as a result of redevelopment dissolution.

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 the remaining ERAF resources alone are not sufficient to fully pay cities and the county for the VLF swap, the county auditor redirects some property taxes from nonbasic aid K-12 and community college districts for this purpose, as shown in step 4. The

Figure 1

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



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

redirection of school property taxes is commonly referred to as "negative ERAF" because it decreases K-12 and community college property taxes rather than supplementing them (the original purpose of ERAF). If ERAF and nonbasic aid school district property taxes combined do not contain enough resources 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.

Step 5: Distribute Remaining ERAF to K-12 and Community College Districts. Any funds remaining in ERAF after the other uses have been satisfied are distributed to schools and offset state education spending.

Examples of the ERAF Distribution Process

While the same rules govern the distribution of ERAF throughout the state, the outcome varies significantly from county to county. This variation reflects the large differences among counties in the amount of property taxes allocated to K-12 and community college districts, the number of students enrolled in K-14 programs, the level of ERAF resources and sales taxes, and other factors. Below, we present four examples using data from 2011-12.

Simplest Example: Alameda County. Property tax collections in the county totaled $2 billion—of which $410 million was deposited in ERAF. Because the county's K-12 and community college districts needed more than $410 million in additional property taxes to meet their revenue limits or guaranteed funding levels, no ERAF resources were returned to cities, counties, and special districts as excess ERAF. Instead, ERAF resources were available to make triple flip and VLF swap payments to cities and the county ($309 million) and the remainder was distributed to nonbasic aid K-12 and community college districts ($101 million).

Negative ERAF: Los Angeles County. Property tax collections in the county totaled about $10 billion—of which $2.08 billion was deposited in ERAF. K-12 and community college districts needed more than $2.08 billion to satisfy their revenue limits or guaranteed funding levels. Therefore, no ERAF funds were returned to cities, counties, and special districts as excess ERAF. The first use of the county's ERAF (before allocating any funds to K-12 and community college districts) was to provide $302 million in triple flip reimbursements to cities and the county. After ERAF funds were distributed for the triple flip, $1.78 billion remained in ERAF to fund VLF swap payments of $1.84 billion—resulting in a shortfall of about $65 million. To cover this shortfall, Los Angeles' auditor redirected $65 million of property taxes from nonbasic aid K-12 and community college districts to ERAF to make the full VLF payment. (The numbers above exclude certain revenues related to the county's policies regarding delinquent property taxes.)

Excess ERAF: Napa County. Property tax collections in the county totaled $275 million—of which $34 million was deposited to ERAF. In total, K-12 and community college districts in the county needed only one-fourth of the funds deposited into ERAF to meet their funding needs. Thus, $25 million of the ERAF resources were first used to offset state expenditures in county special education programs ($7 million), with the remaining funds ($18 million) returned to cities, counties, and special districts as excess ERAF. Following these distributions, just under $9 million remained in ERAF to fund the triple flip and VLF swap. These funds were used first to pay triple flip reimbursements totaling $6 million. The remaining $3 million was applied to a VLF swap obligation of $23 million—resulting in a shortfall of $20 million. To cover this funding shortfall, Napa's auditor redirected $20 million from property taxes of nonbasic aid K-12 and community college districts.

Insufficient ERAF: San Mateo County. Property tax collections in the county totaled $1.4 billion—of which $187 million was deposited to ERAF. In total, the county's K-12 and community college districts needed $38 million from ERAF to meet their guaranteed funding levels, leaving $149 million to distribute to county special education programs ($18 million) and to cities, counties, and special districts as excess ERAF ($131 million). Following these distributions, $38 million remained in ERAF to fund the triple flip and VLF swap. These funds were used first to pay triple flip reimbursements totaling $32 million. The remaining $6 million was applied to a VLF swap obligation of $125 million—resulting in a shortfall of $119 million. To cover this funding shortfall, San Mateo's auditor shifted property taxes from nonbasic aid K-12 and community college districts. Because many K-12 and community college districts in San Mateo are basic aid, however, the amount of K-12 and community college district property taxes available to be shifted was slightly lower ($200,000) than the $119 million needed to reimburse city and county for the VLF swap. Thus, San Mateo County experienced $200,000 of insufficient ERAF.

A RECENT DEVELOPMENT: INSUFFICIENT ERAF

In 2010-11, Amador County found that the resources available from ERAF and nonbasic aid K-12 and community college district property taxes were insufficient to fully fund VLF swap payments to cities and counties. This funding shortfall—the first reported case—is known as insufficient ERAF. If insufficient ERAF occurs, state action is required if cities and counties are to receive full triple flip or VLF swap payments. In the 2011-12, two counties—Amador and San Mateo—reported having insufficient ERAF. This section discusses the factors leading to insufficient ERAF and explores the possibility of insufficient ERAF extending to other counties and affecting payments for the triple flip.

Factors Leading to Insufficient ERAF

Prevalence of Basic Aid School Districts Is the Most Significant Cause of Insufficient ERAF. In general, counties where a greater proportion of K-12 and community college districts are basic aid are more likely to experience insufficient ERAF. The prevalence of basic aid districts can affect the amount of resources available to fund the triple flip and VLF swap in two ways. First, if more K-12 and community college districts are basic aid, there is less capacity to use ERAF to offset state education costs and, therefore, more ERAF is returned to local governments as excess ERAF. Monies returned as excess ERAF are not available to fund triple flip or VLF swap payments. Second, because state law does not allow county auditors to shift property taxes from basic aid districts to fund the VLF swap, an increase in the number of basic aid districts decreases the pool of resources county auditors can draw from to fund the VLF swap. In 2011-12, around 10 percent of K-12 and community college districts in the state were basic aid. In contrast, about two-thirds of K-12 and community college districts in San Mateo County were basic aid and Amador County's only K-12 district was basic aid.

Local Demographics, Property Values, and State Policies Drive Basic Aid Status. A wide range of factors influence whether a K-12 or community college district is basic aid, including economic and demographic factors, as well as state fiscal

and educational policies. In general, basic aid districts (1) receive comparatively high property tax revenue—because of substantial property wealth and/or they receive a higher share of the property tax (for more information on property tax allocation, see our report, *Understanding California's Property Taxes*) and (2) serve a community with a comparatively smaller school-aged population. In addition, changes in state policy can also influence whether a district is basic aid. The number of basic aid districts generally increases when the state decreases K-12 district revenue limits and community college apportionment funding levels, and vice-versa. Changes in revenue limits and apportionment funding levels can be caused by state fiscal actions (such as a reduction of overall state K-14 expenditure) or by state policy changes (such as consolidation of categorical program funding into revenue limits). In addition, state actions that increase the property tax revenue of K-12 and community college districts (such as dissolution of redevelopment) can increase the number of basic aid districts.

Slower Growth of ERAF Contributes Modestly to Insufficient ERAF. Property tax revenues deposited in ERAF are the primary funding source for VLF swap payments. Historically, ERAF resources have grown slightly slower than VLF payments—by up to about 1 percent a year. The slower growth of ERAF relative to VLF swap payments (which grow at the rate of change in assessed valuation) has reduced somewhat the amount of resources available to fund the VLF swap, thus contributing to insufficient ERAF. The overall statewide effect of ERAF's slower growth rate, however, has been small. If ERAF grew at the same pace as VLF swap payments, there currently would be around $340 million more ERAF to fund VLF swap payments—an amount equal to 6 percent of total VLF payments. We note that the difference between ERAF and VLF swap payment growth rates in Amador and San Mateo Counties was not a significant factor contributing to their ERAF insufficiencies.

Insufficient ERAF In Future Years

To date, insufficient ERAF has been a limited issue: only a small number of local governments have been affected and the dollar amount of the insufficiencies has been relatively minor. Going forward, it is difficult to project the magnitude of insufficient ERAF in future years. However, based on our current economic and demographic forecasts and our review of county triple flip and VLF swap financial data, in the absence of significant state educational policy changes, we think it is likely that insufficient ERAF (1) will increase over the next few years (potentially to tens of millions of dollars in some years), (2) may affect triple flip reimbursements in a small number of counties, and (3) will abate considerably after 2016-17 (following the end of the triple flip), possibly continuing to affect a small number of counties on an ongoing basis. We note that these outcomes could be influenced by legislative actions to increase general purpose funding levels for K-12 and community college districts—such as transitioning to a new K-12 weighted student formula—which could substantially reduce future growth in basic aid districts and, therefore, insufficient ERAF. Below, we discuss the rationale underlying our insufficient ERAF projections.

Property Tax Growth Over Next Few Years Could Create More Basic Aid Districts. In 2012-13 and over the next few years, many K-12 and community college districts are expected to receive a significant increase in property tax revenue from the distribution of former RDA assets and an anticipated increase in property values. This growth in property tax revenue is likely to shift temporarily some K-12 and community college districts into basic aid status and, in turn, increase the

number and dollar amount of ERAF insufficiencies experienced by local governments. The ERAF insufficiency faced by local governments in San Mateo County is likely to increase significantly in 2012-13, from $200,000 to several million or more. Also, at least one additional county—Napa—appears at risk of having insufficient ERAF in 2012-13 or the near future. Despite the potential growth of insufficient ERAF over the next few years, the issue is not likely to expand beyond a small number of counties because the vast majority of counties have only a small number of K-12 and community college districts that are basic aid or are close to becoming basic aid.

Chance of Triple Flip Funding Shortfalls. A few counties—San Mateo and Napa—appear somewhat at risk of developing insufficient ERAF as a result of ERAF resources being inadequate to reimburse cities and counties for the triple flip. This situation can occur if a significant portion of a county's ERAF revenues are distributed to special education programs and to local governments as excess ERAF, leaving inadequate funds to reimburse for the triple flip. In 2011-12, over 70 percent of ERAF monies in San Mateo and Napa counties were distributed to special education programs and as excess ERAF, leaving less than 30 percent of ERAF to fund the triple flip and VLF swap. Most of the funds remaining in ERAF were used to reimburse the triple flip. For this reason, a relatively small increase in excess ERAF distributions—for example, a 5 percent increase in San Mateo County—likely would result in a triple flip funding shortfall. It is possible such an increase in excess ERAF distributions could result from expected growth in property values in San Mateo and Napa counties over the next few years. Because the triple flip is scheduled to end in 2016-17, any triple flip related insufficient ERAF would be a temporary, short-term issue.

End of Triple Flip Should Decrease ERAF Insufficiencies. Any growth in insufficient ERAF that occurs over the next few years is likely to be reversed beginning in 2016-17. As mentioned previously, the Proposition 57 deficit-financing bonds are projected to be repaid in 2016-17 and the triple flip will end. At that time, there will be roughly $1.7 billion (about one-third of statewide VLF swap payments) more ERAF funding available statewide to fund the VLF swap—significantly decreasing the likelihood of VLF swap funding shortfalls. In addition, state K-14 expenditures are projected to increase consistently between 2013-14 and 2017-18, likely leading to growth in revenue limit entitlements for K-12 districts and apportionment funding levels for community colleges. To the extent growth in revenue limits and apportionment funding exceeds growth in K-12 and community college district property taxes, the number of basic aid districts could decrease. The combination of these factors should reduce the possibility of local governments experiencing insufficient ERAF. As a result, beginning in 2016-17, it is likely that insufficient ERAF will be limited to a small number of counties—or perhaps nonexistent in some years—for the foreseeable future.

ADDRESSING INSUFFICIENT ERAF

In addressing claims of insufficient ERAF in future years, the Legislature is faced with two primary decisions: how much compensation cities and counties should receive and how the compensation should be provided. In the sections that follow, we provide a framework the Legislature may wish to use in considering these decisions.

How Much Should Cities and Counties Be Compensated for Insufficient ERAF?

Deciding the amount of compensation to provide is difficult and inevitably requires the Legislature to make trade-offs between providing funding for state versus local government programs—and weighing implicit commitments made by previous Legislatures. As we discuss below, we think a strong analytical argument can be made for developing a funding mechanism that provides full reimbursement for all shortfalls in triple flip and VLF swap reimbursements. However, it would also be reasonable for the Legislature to consider a lower level of reimbursement for VLF swap funding shortfalls in recognition of an additional unforeseen outcome of the VLF swap: cities and counties have received a significant fiscal benefit from the VLF swap due to unexpected growth in VLF swap payments. Should the Legislature wish to provide a lower level of support, we think a reasonable alternative would be to (1) provide full reimbursement for all triple flip losses and (2) reimburse VLF swap shortfalls to the extent that a local government did not receive more revenues under the VLF swap than it would have if the VLF rate had remained 2 percent.

Providing Full Reimbursement. The legislative record is unambiguous that the state intended to provide each city and county with (1) dollar-for-dollar reimbursement for their local sales tax losses associated with the triple flip and (2) VLF swap payments equal to the local government's 2004-05 VLF losses, grown by annual change in its assessed value. The Legislature specified that the resources to provide this compensation were to be property taxes in ERAF and, if necessary, property taxes redirected from nonbasic aid K-12 and community college districts—a funding system that was believed to be sufficient to accomplish the Legislature's objective. The funding insufficiency that has developed is a byproduct of California's complex system of local finance and not the result of any actions by cities and counties. Therefore, there is no clear reason that some local governments should get lower levels of reimbursement simply because they are located in a county with insufficient ERAF.

Alternative: Fully Reimburse Actual Local Government Revenue Losses. While it is clear the Legislature intended for VLF swap payments to grow with annual changes in assessed valuation, it is not clear the Legislature could have known this would result in most cities and counties receiving VLF swap payments significantly in excess of their VLF losses. As discussed in the nearby box (see next page), VLF swap payments have grown relatively quickly since 2004, significantly surpassing the amount of VLF revenues that local governments lost as a result of the VLF swap. Local governments today are receiving $2 billion more annually than they would have received if the VLF rate had been left at 2 percent. In recognition of this fact, the Legislature may wish to consider an alternative approach to insufficient ERAF which limits reimbursement to the actual amount of sales tax and VLF losses a local government experienced. Under this approach, all triple flip shortfalls would be reimbursed, but the state would reimburse VLF swap shortfalls only to the extent that the local government had not already received at least the same amount of funding it would have received if the swap had not occurred and the VLF rate was 2 percent. This limitation on VLF reimbursement would decrease the magnitude of state liabilities—no additional reimbursement would be required for the cases of insufficient ERAF that have occurred to date. While the analytical argument for this alternative is less straightforward, it is consistent with the notion that the state's goal was to hold local governments harmless from the fiscal effects of the VLF rate reduction—not to increase local government revenues overall.

How Should Compensation Be Provided to Cities and Counties?

After deciding how much compensation to provide to local governments, the next decision for the Legislature is to design a financing mechanism to provide the funds. Given the Constitution's many provisions limiting state authority over local finance, we see only two primary options: provide the compensation in the annual state budget or through a redirection of certain local education agency property tax revenues. We discuss these alternatives below.

Annual State Budget Appropriations. In the 2012-13 state budget, the Legislature addressed insufficient ERAF by providing the affected local governments with a one-time allocation from the General Fund. Continuing this approach in future years would allow the Legislature to weigh the expense of providing insufficient ERAF compensation against other state spending priorities on an annual basis. On the other hand,

A Look at Growth in Vehicle License Fee (VLF) Payments

VLF Swap Payments Have Grown Faster Than VLF Revenues. Each year, a city's or county's VLF payment increases (or decreases) proportionately to the change in its assessed valuation. After the adoption of the VLF swap, statewide growth in assessed valuation—and, as a result, VLF swap payments—has significantly exceeded growth in VLF revenues. From 2004-05 to 2011-12, VLF swap payments grew by an average of about 5 percent each year, while VLF revenues declined by an average of about 0.5 percent each year. Consequently, annual statewide VLF swap payments now are roughly $2 billion (around 45 percent) greater than the VLF revenues lost by cities and counties. This large fiscal benefit for cities and counties was not foreseen at the time the VLF swap was adopted. Prior to the VLF swap, historical growth in assessed valuation and VLF revenue had been fairly comparable.

City and County Fiscal Benefits Vary Significantly. While most cities and counties have benefited from the faster growth of VLF swap payments, some cities and counties with less growth in assessed valuation or more growth in population have received less benefit from the VLF swap than other cities and counties. Our estimates of the benefits (or losses) of individual cities and counties—measured in terms of the percentage gain or loss in VLF swap payments relative to VLF revenue losses—range from losses of a few percent to gains in excess of 80 percent. In terms of the two counties that have insufficient Educational Revenue Augmentation Fund (ERAF) (Amador and San Mateo), our analysis indicates that local governments in these counties have benefited under the VLF swap, but not more than most other cities and counties.

Choice to Tie VLF Swap Payments to Assessed Value Was Significant. In enacting the VLF swap, the state departed from its prior policy of replacing city and county VLF revenue losses dollar for dollar and instead linked growth in VLF swap payments to growth in assessed valuation. Had the state adopted a mechanism that provided for reimbursement of city and county actual VLF revenue losses only, annual payments to cities and counties would be about $2 billion less today than under the VLF swap. This would reduce the occurrence of insufficient ERAF, including eliminating Amador and San Mateo's status as counties with insufficient ERAF.

subjecting insufficient ERAF compensation to annual review would reduce revenue security for cities and counties. We note that the Legislature designed the current triple flip and VLF swap payment mechanism to be controlled at the local level with the objective of giving local government revenue security.

Redirect Property Taxes From Some Local Educational Entities. Current law allows auditors to redirect property taxes from nonbasic aid K-12 and community college districts to fund the VLF swap. These districts' property tax losses are backfilled with state aid. Current law does not allow auditors, however, to redirect (1) K-12 or community college district property taxes to fund the triple flip or (2) county offices of education (COE) and special education program property taxes to fund the triple flip or VLF swap. Expanding county auditor authority to redirect property taxes from all of these educational agencies for the triple flip and VLF swap would provide additional funding that could be used to avoid ERAF insufficiencies. Similar to K-12 and community college districts, COE and special education programs receive a particular level of annual funding through a combination of local revenues and state aid. If the property tax revenues received by COEs or special education programs decrease, the state typically provides additional state funding to achieve a specified funding level. Therefore, total funding to these entities likely would not decrease if county auditors were permitted to redirect some of their property taxes to fund the triple flip and VLF swap.

Our review indicates that redirecting property tax revenues from COEs and special education programs would cover most, but not all, of the current costs of insufficient ERAF in Amador and San Mateo Counties. Similarly, this funding mechanism might not be sufficient in future years if the scope of insufficient ERAF is constant or expands. Consequently, if the Legislature wishes to provide full reimbursement for all triple flip and VLF swap funding shortfalls, supplemental General Fund appropriations will be required to compensate cities and counties.

The Redirection Option Raises Two Important Considerations. In considering this option, the Legislature should be aware of two important considerations. First, if the actual amount of property taxes allocated to COEs or special education programs in a given year ends up being less than was expected at the time the state budget was enacted, additional state funding would need to be provided if COEs and special education programs are to reach their specified funding levels. State policies addressing this situation differ between COEs and special education programs. As with K-12 districts, COE funding shortfalls are backfilled automatically with additional state aid. On the other hand, an additional state appropriation would be needed to backfill special education funding shortfalls—similar to community colleges. While the issue of differing approaches to backfilling local educational agencies' property tax revenues extends far beyond insufficient ERAF and the scope of this report, the Legislature should be aware that the ramifications of shifting property taxes from local educational agencies to fund the triple flip and VLF swap may vary across entities. Second, the Constitution constrains the Legislature's ability to alter the allocation of property tax revenues—even in cases when the state would be providing cities and counties with *increased* property taxes. Legislation authorizing property taxes to be shifted from COE or special education programs may require approval by two-thirds of both houses of the Legislature.

CONCLUSION

Over the last two years, local governments in two counties—Amador and San Mateo—did not receive enough revenue to offset two complex state-local financial transactions: the triple flip and VLF swap. It is likely this funding insufficiency, commonly called insufficient ERAF, will continue in future years, requiring state action if the affected local governments are to receive their full triple flip and VLF swap payments. In addressing future claims of insufficient ERAF, the Legislature will be faced with the difficult decisions of how much compensation cities and counties should receive and how it should be provided. Ultimately, in making these decisions, the Legislature to will need to balance trade-offs between providing funding for state versus local government programs and weigh implicit commitments made by previous Legislatures.

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This brief was prepared by Brian Uhler 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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