

## Memorandum

**TO:** East Contra Costa Fire Protection District Board of Directors  
Brian Helmick, Interim Fire Chief

**FROM:** Shayna M. van Hoften, Legal Counsel  
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**DATE:** September 7, 2017

**RE:** Legal Analysis of Proposed Property Tax Revenue Reallocation Measures

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In recent months, a local elected leader, community members and local organizations have proposed various voluntary and mandatory reallocations of property tax revenues between or among the agencies in Contra Costa County to increase the resources available to East Contra Costa Fire Protection District (District). An earlier memorandum to the Board, dated April 29, 2016, addresses the voluntary transfer of revenues from an individual agency to another. This second memorandum sets forth the legal context, opportunities and limitations of two additional proposed measures: (1) amendment of the property tax revenue allocation formula in the Revenue and Taxation Code; and (2) reallocation of property tax increment through the establishment of an Emergency Services Additional Revenue District. In sum, we conclude that enactment of both proposed measures face significant challenges.

### I. BACKGROUND

#### 1. District Funding Crisis

The District serves over 114,000 residents in an area covering 249 square miles. The District currently receives 7.5% of the property tax revenue generated within its boundaries, as compared to the other fire protection agencies in Contra Costa County which receive 12 to 30+% of the property tax revenues generated in their jurisdictions. Property tax revenues account for about 90% of the District's funding. The District's current revenues allow it to operate three fire stations—down from eight stations in 2010—and fund operation of the CalFire Sunshine station during non-fire season.

Previous measures to generate additional revenue through new taxes or assessments have been unsuccessful. In June 2012, voters in the District rejected a ballot measure to enact a \$197 parcel tax for a total of \$4.2 million in additional funds to allow District operation of six stations. Then, in April 2015, property owners in the District rejected a proposed benefit assessment that would have funded District operation of five stations. In November 2016, voters in Oakley and Brentwood rejected proposed utility user taxes that could have funded increased fire protection service in their respective cities.

#### 2. California's 1% Ad Valorem Property Tax

In 1978, California voters enacted Proposition 13, which limited California property taxes to 1% of a property's full cash value ("ad valorem property tax"). (Cal. Const. Art 13, Sec. 1(a).) The

property tax for each parcel is calculated based on the property's value as shown on the 1975-76 County Assessor's role ("assessed value"). Properties can be reassessed *down* to reflect drops in the housing and real estate markets. Properties can be reassessed *up* only (1) when there is a change in ownership, (2) when certain new construction on a property has increased its value, and (3) to account for inflation. The annual inflation rate for the increase is tied to the consumer price index (CPI) but limited to 2% per year. (Cal. Const. Art. 13A, Sec. 2(a), 2(b).) (Note that the yearly CPI is often lower than 2%.)

The annual increase to property taxes collected each year due to reassessment and increased CPI is known as "**tax increment**." For long-term budgeting purposes, the District generally plans for a 2% increase in property tax revenues.

### **3. Allocation of Ad Valorem Property Tax Revenues**

Once collected by the County, property tax revenues associated with each parcel are distributed to various government agencies with taxing authority over that parcel. Over twenty entities share the 1% property tax revenues on parcels within the District, including the City of Oakley, the City of Brentwood, Contra Costa County, the County Library, BART, the Bay Area Air Quality Management District, several school districts, a flood control district, and a mosquito abatement district.

Allocations of taxes to the many agencies in each taxing area were established according to a formula set forth in the California Revenue and Taxation Code. (Cal. Rev. & Tax Code §§ 96 *et seq.*) Unfortunately for relatively younger agencies, the allocation formula was developed in 1979, and reflects the services provided by each agency with taxing authority at that time. Agencies that were formed after 1978 are known as a "post-Prop. 13" agencies.

As a post-Prop. 13 agency, the District's share of the property tax revenues collected in its service area is limited to those shares calculated for its predecessor agencies, which were mostly small volunteer departments serving a mostly rural community.

The statutory formula has been adjusted over the years to account for various inequities, including several reallocations known as "Tax Equity Allocations." These reallocations primarily shifted property tax revenue among counties, cities, and school districts.

## **II. LEGAL RESTRICTIONS ON REALLOCATION OF PROPERTY TAX REVENUES**

In recent years, changes to the Revenue and Taxation Code and the California Constitution have placed increasing limitations on the State and local legislatures' ability to reallocate property tax revenue. The most applicable restrictions to the proposed reallocations are Proposition 1A and Revenue and Taxation Code section 99.02 (Section 99.02).

In 2004, voters enacted Proposition 1A to limit the ability of the State Legislature to reallocate property tax revenue among agencies within a county. Proposition 1A amended the Constitution to require a two-thirds vote by each house of the Legislature to "change for any fiscal year the pro rata shares in which ad valorem property tax revenues are allocated among local agencies in a county." (Cal. Const. Art. 13, Sec. 25.5(a)(3).)

Then, in 2010, the Legislature amended Section 99.02 to impose additional restrictions on transfers of property tax revenue among local agencies initiated by the local agencies. Section 99.02 states that an agency may transfer any portion of its property tax revenues to another local agency receiving property tax revenues from the same tax rate areas. (Cal. Rev. & Tax. Code § 99.02(b).) These transfers are subject to certain restrictions. Prior to transferring the revenue, the transferring agency must make the following determinations: 1) that revenues are available for the transfer; 2) that the transfer will not increase the ratio between the transferring agency's revenues generated by regulatory licenses, use charges, user fees, or assessments and revenues used to finance services provided by the transferring agency; 3) that the transfer will not impair the transferring agency's ability to provide existing services; and 4) that property tax revenues to school entities will not be reduced. (Cal. Rev. & Tax. Code § 99.02(f).) (See the April 29, 2016 memo for a more detailed analysis of Section 99.02.)

### **III. ANALYSIS OF PROPOSALS**

#### **1. State-directed Property Tax Reallocation Proposal**

The first proposal to obtain additional property tax revenue for the District is to pursue legislation similar to previous Tax Equity Allocations, which would shift property tax revenue from other agencies within the County to the District.

##### **A. Significant legislative barriers must be overcome to enact a Property Tax Reallocation.**

While legally possible, this proposal would be difficult legislatively and politically. Forcibly reallocating property tax revenues from other agencies within Contra Costa County to the District would require the State Legislature to amend the allocation formula in the Revenue and Taxation Code. Pursuant to Proposition 1A, such a change would require a two-thirds vote by each house of the Legislature and approval by the Governor. (Cal. Const. Art. 13, Sec. 25.5(a)(3).)

#### **2. Emergency Service Additional Revenue District Proposal**

The second proposal is to establish an entirely new type of government entity called an Emergency Service Additional Revenue District (ESARD). As proposed, the ESARD would be led by a governing board consisting of representatives from the various agencies receiving property tax from parcels in the District's service area. The ESARD would borrow, or enable the District to borrow, money from the State for use by the District for the provision of emergency services. The ESARD or the District would then repay the loan with a portion of tax increment that would otherwise have gone to other agencies in Contra Costa County. The proposal assumes the District also could use additional tax increment to fund fire protection services directly. The proposal includes an exemption for cities and possibly school districts from allocating increment to the District.

**A. Significant legislative barriers also must be overcome to form and fund an ESARD.**

Establishment of a new form of local government typically would require a simple majority vote of the Legislature and approval by the Governor. Depending on how the law is written (e.g., if it is a general authorizing statute rather than a statute specifying the area to be covered), Contra Costa County's Local Agency Formation Commission may also need to approve the creation and/or bounds of the ESARD. (See Cal. Gov. Code §§ 56375 *et seq.*)

Secondarily, depending on how the underlying legislation is written, giving an ESARD its proposed powers likely would require a supermajority vote by the Legislature because reallocating tax increment from other agencies within Contra Costa County to the District via an ESARD would require the Legislature to amend the tax allocation formula. Furthermore, each future adjustment to the allocation of tax increment allocated to the ESARD could require approval by the governor and a two-thirds vote of the Legislature. (Cal. Const. Art. 13, Sec. 25.5(a)(3).)

Third, successful operation of an ESARD is predicated on the willingness of the State to make loans to fund District services for whatever time periods may be required. The proposal does not identify any State program or any other available revenue source to fund such loans.

Finally, given the limited revenue likely to be available to an ESARD, as discussed below, it is unclear what kind of loan terms would be necessary to enable the ESARD or District to repay such loans. (See Section III.2.D.)

**B. Section 99.02 may restrict the ESARD's ability to reallocate increment.**

In addition to the barriers described above, the ESARD concept raises questions about Section 99.02 (unless such questions are resolved in the ESARD enabling legislation).

As proposed, the ESARD would be governed by a board of directors consisting of representatives from the agencies that would be contributing tax increment to the District. Accordingly, any decision by the ESARD board to reallocate the contributing agencies' shares of tax increment may require, or could be construed as, a decision of those agencies that appointed the board members.

Accordingly, the decisions could be subject to Section 99.02's limits on transfers of property tax revenues (described in more detail in the April 29, 2016 memo). If the transfers are subject to Section 99.02, all school entities, including school districts, community college districts, and individual schools, would need to be excluded from the ESARD in order to avoid running afoul of the limitation on transfers in Section 99.02(f)(4). Furthermore, the remaining transferring agencies would have to comply with Section 99.02(f)(1)-(3). In particular, the transferring agencies, as a precursor to agreeing to the transfer, would need to declare that the lost property tax would not result in service cuts or in increased use charges, fees or assessments to offset the contemplated property tax transfer.

**C. Reallocation of tax increment would hamper other agencies.**

Agencies funded with property tax revenues rely on tax increment to maintain their service levels and keep up with ever-increasing costs. Accordingly, even if the legal, legislative and financial barriers to creation and operation of an ESARD are overcome, the District's gain will likely hamper other agencies' abilities to maintain services, much less expand them, for as long as the ESARD exists.

Stated another way, while allocating larger shares of tax increment to the District does not decrease the nominal dollar amount historically allocated to any other agency, the real value of the property tax revenue allocated to each other agency would decrease. Absent atypical deflation or another unanticipated economic event, the cost of goods and services increases each year, as tracked by the consumer price index. If an agency's funding does not keep pace with this increase, its ability to provide essential services may decrease even though the dollar amount in its budget has remained steady. As property taxes for non-reassessed properties cannot increase by more than the consumer price index (capped at 2%), all of the revenue generated by tax increment already is necessary for most or all agencies to maintain existing service levels. Further, Section 99.02 would be violated if agencies transferring increment to the District are required to cut services as a result. (Cal. Rev. & Tax. Code § 99.02(f)(3).)

**D. An ESARD may not be able to transfer substantial additional revenue to the District.**

The maximum additional funding made available to the District through the ESARD would likely be no more than a third of all increment generated by reassessment of property in the District's service area. As previously discussed, there are three sources of increment: (1) increases in property value; (2) changes in ownership; and (3) certain new construction. (See Section I.2.) An ESARD could not reallocate any increment generated by increased property values to the District without cutting funding to other agencies that rely on the increment. (See Section III.2.B.)

Of the remaining increment, the exemption of cities and school districts from the ESARD proposal substantially limits the amount of tax increment available to transfer to the District. School entities, which are proposed to be exempt and which may be ineligible to participate in the ESARD under Section 99.02, receive about 49% of property tax revenue countywide. They would likely be entitled to a similar share of the remaining increment. The proposal further exempts the City of Oakley and the City of Brentwood from contributing tax increment to the ESARD. Cities receive about 8% of property tax revenue countywide.<sup>1</sup> The amount of increment to which Oakley and Brentwood are entitled could be higher than 8% if property transfers and new construction within the District's service area is concentrated in Oakley and Brentwood. An additional 7.5% already goes to the District.

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<sup>1</sup> Contra Costa county Auditor-Controller, "Where Your Property Tax Dollars Go" available at <http://www.co.contra-costa.ca.us/1125/Tax-Information> (last accessed August 30, 2017). Different Tax Rate Areas contribute different amounts to school districts and cities based on the formula set forth in the Revenue and Taxation Code.

Assuming all other agencies forfeit all of their eligible increment to the District, this leaves about 35.5% of the increment generated by the sale of properties and new construction in parcels that are in the unincorporated Contra Costa County portion of the District's service area.<sup>2</sup>

**E. An ESARD does not compare well with redevelopment agencies.**

Finally, we note that a comparison has been made between the ESARD proposal and the financing model for former redevelopment agencies. However, the comparison omits a key distinction. Redevelopment agencies borrowed against future tax increment to fund new development. In turn, the new development spurred by redevelopment typically resulted in the improvement, purchase, and sale of property, thereby compounding the increases in tax increment, in a self-supporting cycle. While the ESARD proposal also involves borrowing against future increases in tax increment, it would use that revenue to fund services and includes no mechanism to invest in or substantially stimulate creation of additional tax increment in the future.

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<sup>2</sup> An additional 11% of property tax revenue currently goes to successor agencies to redevelopment agencies. This increment may not be available if the agencies are obligated to use the increment from redevelopment areas to pay bonded debt.