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Commentary

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In Pursuit of Equity in Property Tax Allocation: Discussing the Flawed Implementation of Proposition 13**

Keywords: California politics; property tax; Proposition 13; taxes; tax revolt

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1 Introduction

On November 2, 2010 – nearly 30 years after his previous stint as governor – Californians gave Jerry Brown another chance. When Brown began his third term as California’s governor in January 2011, he faced a challenge to fix a state that many feel is beyond repair – smothered by the rambunctious growth of both its economy and government. California is already known for its perpetual budget problems, but the recent national recession has put the state under incredible fiscal pressure. Californians require greater state services as a safety net, while contributing less revenue through income tax. Localities face the same pressures, as well as painful cuts from the state. At least one city has gone bankrupt.¹ Given that California is teetering on a financial precipice with an estimated \$28.1 billion budget deficit, Brown has signaled his willingness to focus gubernatorial scrutiny on one measure passed during his first term as governor – Proposition 13 – which people in California and beyond have long assumed to be sacrosanct.

As a candidate during the 2010 election cycle, Brown shocked Sacramento when he hinted at his readiness to touch what is known as the third rail of

** This article first appeared in the *Virginia Tax Review* in Spring 2011.

¹ Carolyn Jones, *Vallejo votes to declare Chapter 9 bankruptcy*, S.F. Chronicle, May 7, 2008, at B1.

California politics: Proposition 13.² Had such a statement come from any other candidate, it might be explained away as mere bluster. The words carry far more significance, though, coming from a politically savvy former governor who opposed the initiative when it passed during his first term. If done wisely, revisiting aspects of Proposition 13 could be the key to solving some of the underlying fundamental fiscal problems of city governments, county governments, and special districts throughout the state.

This saga began when California's voters overwhelmingly approved Proposition 13 in 1978.³ One of the most infamous state initiatives ever enacted, Proposition 13 dramatically reformed the system of property taxation in California.⁴ As a measure designed to protect homeowners, Proposition 13 drastically reduced the levels of revenue available to all levels of government in the state.

In response to the rapid conversion of the property tax system, the state legislature moved hastily to implement measures softening the blow of lost property tax revenues and governing future methods by which stakeholders would divide money.⁵ In addition to providing a significant degree of bailout funding, lawmakers approved property tax allocation measures that relied heavily on historical funding trends. Today, this property tax allocation system continues to serve as the backbone for distributing Proposition 13 monies despite its inability to adjust to the current needs of local agencies.

Although Proposition 13 remains popular and was replicated in other states, much of today's blame for California's notorious budget issues can be traced back to this nearly 35-year-old initiative. Many commentators have suggested reforming Proposition 13 to alleviate the difficulties in California, but few have highlighted the property tax allocation system itself as a target for reform.

When assessing California's property tax dilemma, the strengths and weaknesses of the Legislature's response to Proposition 13 may be more important than evaluating the tenets of the initiative itself. Exploring beneath the Proposition 13 system's surface quickly reveals the inequities and inefficiencies inherent in the

2 Press Release, Howard Jarvis Taxpayers Assoc., HJTA takes on Jerry Brown over Proposition 13 (October 14, 2010), *available at*

<http://www.hjta.org/press-releases/pr-hjta-takes-jerry-brown-over-prop-13>

3 Jennifer Ehn, Capital Center for Public Law & Policy, Proposition 13 at Twenty-Five (2004),

http://www.mcgeorge.edu/Research_Centers_and_Institutes/

[Capital_Center_for_Public_Law_and_Policy_Home/Publications/California_Initiative_Review/California_Initiative_Review_Reports/Proposition_13_at_Twenty-Five.htm](http://www.mcgeorge.edu/Research_Centers_and_Institutes/Capital_Center_for_Public_Law_and_Policy_Home/Publications/California_Initiative_Review/Capital_Center_for_Public_Law_and_Policy_Home/Publications/California_Initiative_Review/California_Initiative_Review_Reports/Proposition_13_at_Twenty-Five.htm) ("With an overwhelming 2 to 1 vote, Proposition 13 passed and carried nearly every county in the state.")

4 Cal. Const. art. XIII.A.

5 Assem. 8, 2011 State Assem., Reg. Sess. (Cal. 2011); S. 154, 2011 S., Reg. Sess. (Cal. 2011).

state's responses via Senate Bill 154 ("SB 154"), Assembly Bill 8 ("AB 8"), and other measures related to the allocation of property tax revenues. While Proposition 13 forced local governments to rethink revenue growth and service delivery – spurring the emergence of a phenomenon known as the "fiscalization of land use" – the allocation system only intensified the problem. The property tax allocation system's rigidity prohibits revenue from being allocated in a way that reflects modern needs. It also centralizes the authority over local revenues at the state level.

This paper recommends several measures to alleviate the negative effects of the allocation system. This would predominantly occur via the creation of regional commissions, with the authority to adjust property shares, and the defunding of special districts. Ultimately, the effects of our suggestions will encourage shifts – to varying degrees – of power from the state back to local agencies. As Brown campaigned on restoring local control, these suggestions fall squarely within his vision as governor.

Part I places Proposition 13 in a historical context by examining the cause-and-effect process that led to the enactment of Proposition 13. This will help us understand the context of the initiative so that proposals for reform stay true to the intent of California voters. Part II builds on this analysis by describing the regime developed by legislators to implement Proposition 13. Specifically, this section highlights the allocation system used to distribute property tax money to local agencies. Part III focuses on the phenomenon known as the "fiscalization of land use" – an unintended consequence of this allocation system – as well as the diminished power of local government vis-à-vis the state. Lastly, Part IV offers proposals for reform that will restore equity between local agencies, as well as between the state and local government.

2 The Enactment of Proposition 13

As a voter-approved constitutional amendment, Proposition 13 limited the discretion of local government to set its own rates on property taxes, which had been a forceful tool to raise revenue for government services. Specifically, Proposition 13 capped the property tax rate at 1%. Furthermore, Proposition 13 does not tax the fair-market value of homes (except when ownership is transferred). Rather, Proposition 13 rolled back property values to their 1975–1976 values, and then only permits a 2% increase in property value each year to account for inflation.⁶ Lest

⁶ Cal. Const. art. XIII.A.

state or local legislatures be tempted to raise other taxes to ameliorate the effects of the lost property tax revenue, the initiative required that all future state tax increases be approved by two-thirds of both houses of the California state legislature and that cities, counties and special districts only impose “special taxes” with the approval of two-thirds of voters.⁷

Proposition 13 was designed to protect homeowners. Yet, in doing so, it fundamentally changed the revenue growth of local governments. If we are to suggest tax allocation reforms that stay true to the voters’ intent, it is helpful to understand what caused the passage of the initiative in the first place. Proposition 13, dubbed “a people’s movement,” emerged as a response to economic grievances. Predominantly, property value inflation led to dramatically higher property taxes. Adding to the mounting fiscal pressure, the social acceptance of property tax increases eroded quickly after a series of California Supreme Court rulings that delinked property tax and local school spending.⁸ The fiscal realities of the 1970s resulted in growing taxpayer resentment, which state politicians exacerbated by failing to provide relief despite a state surplus. The result? Californians’ frustration was channeled into passing Proposition 13 with a record-breaking vote.

2.1 Inflation

Inflation was perhaps the most prominent instigator of Proposition 13. The US government faced a large deficit stemming from the costs of the Vietnam War in the 1970s and the Great Society in the 1960s. This deficit, coupled with untimely supply shocks, caused devastating inflation. During the 1960s and 1970s, the rate of inflation in the USA jumped from the low single digits to double digits.⁹

Simultaneously, property values in California quickly skyrocketed. The costs of financing construction escalated as a result of rising interest rates (the national response to inflationary trends) and delays in development from new government regulations, such as the 1970 California Environmental Quality Act. Concurrently, the demand for homeownership grew as the California population expanded.

⁷ “Special taxes” were not defined in the proposition, leading to the passage of Proposition 62. Darien Shanske, Note, *Public Tax Dollars for Private Suburban Development: a First Report on a National Phenomenon*, 26 Va. Tax Rev. 709, 719 (2007).

⁸ See *Serrano v. Priest (Serrano I)*, 487 P.2d 1241 (Cal. 1971); *Serrano v. Priest (Serrano II)* 557 P.2d 929 (Cal. 1976).

⁹ J. Bradford De Long, *America’s Peacetime Inflation: The 1970s*, in *Reducing Inflation: Motivation and Strategy* (Christina Romer & David Romer. eds., 1997).

These factors contributed to the average value of California homes inflating from \$34,000 to \$85,000 between 1974 and 1980.¹⁰ The consequence of these trends – higher property values coupled with inflation – was that higher property values translated into higher property taxes without a parallel increase in real income.

2.2 The Petris-Knox Reforms

Unfortunately, the Petris-Knox reforms, responses to crooked tax assessors, prevented tax assessors from making adjustments to provide relief to individual homeowners.¹¹ In 1967, the legislature passed the Petris-Knox reforms after prominent newspaper stories reported the scandalous practices of corrupt county assessors who tinkered with tax assessments in exchange for bribes.¹²

Seemingly innocuous changes that aspired to create minor reforms of a complex property taxation structure, the Petris-Knox reforms took away much of the discretionary power that assessors used to smooth assessment growth. Petris-Knox required more accurate and uniform assessment of all property, mandated systematic reassessment every three years, and sharply limited the discretion of county assessors in adjusting property values.

The unintended consequence of the Petris-Knox reforms was their negative effect on homeowners. For the most part, single-family dwellings received a lower tax rate than businesses, so that county assessors would remain popular on election day. In San Francisco, for example, the average single-family dwelling had been receiving about 9% of fair market value, while businesses were assessed at 35%.¹³ Because of the Petris-Knox bill, many homeowners saw their property tax bills increase while businesses saw theirs decline.

¹⁰ For a general discussion of Proposition 13's background, see Kirk J. Stark, *The Right to Vote on Taxes*, 96 NW. U. L. Rev. 191, 197–201 (2001). See also J. Wildermuth, *Prop 13 – The People's Revolution*, S.F. Chron., May 20, 1998, at 8.

¹¹ See Kathryn Julia Woods, *California's Voters Revolt: Lynwood, California and Proposition 13, A Snapshot of Property's Slipping From Whiteness's Grasp*, 37 UWLA. L. Rev. 171, 186–88 (2004).

¹² Jeffrey I. Chapman, *The Continuing Redistribution of Fiscal Stress: the Long Run Consequences of Proposition 13*, 13 (1998) (unpublished working paper, on file with the Lincoln Institute of Land Policy); Diane B. Paul, *The Politics of the Property Tax 101* (1975) (explaining that San Francisco was the city whose crooked assessment practices had sparked the state's 1967 legislation, which turned out to be contrary to San Francisco homeowners' interests: after the first honest reassessment, bumper stickers appeared that read, "[b]ring back the crooked assessor.").

¹³ Jeffrey I. Chapman, *supra* note 12, at 13.

Even worse, Petris-Knox prevented county assessors from adequately responding to the effects of quickly escalating home values in California between 1973 and 1978. With mandated adjustments at least every three years, homeowners might discover 40–60% increases in their property tax bills.¹⁴

2.3 The Serrano Decisions

The social acceptance of increases in property taxes evaporated when the California State Supreme Court declared in two major decisions known as *Serrano I* (1971) and *Serrano II* (1976) that California's property-tax-based school finance system was a violation of equal protection principles.¹⁵

Economist William Fischel linked the *Serrano* decisions to Proposition 13 by arguing that it eliminated the Tiebout-Hamilton view of local benefit taxation. Under the Tiebout theory – given certain assumptions, such as interjurisdictional competition and costless mobility – local public goods are provided at efficient levels. Individuals “vote with their feet” and select membership in a community that provides the bundle of amenities that match their preferences. Localities, therefore, compete to attract taxpayers by offering a mix of taxes and services that will suit their demands. The Hamilton “benefit view” of the property tax says that homeowners agree to pay higher property taxes because this money funds services and amenities the property owner desires.¹⁶ Fischel argued that by divorcing local property taxes from local school spending, *Serrano* encouraged the passage of Proposition 13 because voters no longer received the benefits of higher property taxes – either through better schools for their children or in higher home values caused by improved school districts.¹⁷ Importantly, school funding was the largest component of the property tax.¹⁸

14 *Id.* at 15.

15 *Serrano v. Priest (Serrano I)*, 487 P.2d 1241, 1244 (Cal. 1971); *Serrano v. Priest (Serrano II)* 557 P.2d 929, 970 (Cal. 1976).

16 Darien Shanske, *supra* note 7, at 749.

17 See William A. Fischel, *How Serrano Caused Proposition 13*, 12 J. L. & Pol. 607 (1996); William A. Fischel, *Did John Serrano Vote For Proposition 13? A Reply to Stark and Zasloff's "Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?"*, 51 UCLA L. Rev. 887 (2004) [hereinafter *Reply to Stark and Zasloff*]. But see Kirk Stark & Jonathan Zasloff, *Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?*, 50 UCLA L. Rev. 801 (2003); Isaac Martin, *Does School Finance Litigation Cause Taxpayer Revolt? Serrano And Proposition 13*, 40 Law & Soc'y Rev. 525 (2006).

18 *Reply to Stark and Zasloff*, *supra* note 17, at 927.

Once the perceived benefit to local schools was unlinked, homeowners rejected the property tax through Proposition 13.

Before these decisions, local property taxes went to a local school district with minimal state involvement in its distribution. This arrangement created an inequitable system in which poor communities were unable to generate per-pupil revenue equivalent to wealthy communities even when they equally taxed their residents.¹⁹ For instance, in 1976, a poor community like Baldwin Hills would generate \$176 per child with a property tax rate of \$1 per \$100 of home value, whereas Beverly Hills generated \$1340 per child with the same tax rate.²⁰

The California Supreme Court ruled that this system disproportionately favored wealthy communities.²¹ The court held that, under the Equal Protection Clause of the Fourteenth Amendment to the US Constitution and the requirement under the California Constitution that the legislature provide a free public school system for each district, the property-tax-based school finance system was unconstitutional; the state had to distribute revenue more equitably.²²

The state responded with Assembly Bill 65, a measure that equalized school spending by capping the rate of local revenue that a school district could receive and by distributing excess amounts among the poorer districts.²³ On paper, this system mitigated the inequity in property-tax-based school financing between low-income and high-income communities. The downside, however, was that property owners in high-income communities felt hoodwinked because a share of their property taxes might end up in schools outside the local district.²⁴ The state quickly learned that social acquiescence to increases in property tax proved inelastic once school funding was separated.²⁵

¹⁹ See *Serrano I*, 487 P.2d at 1263.

²⁰ Deborah Martinez Granger, Allocation of Resources and Educational Adequacy: Case Studies of School-Level Resource Use in Southern California Title I Program Improvement Middle Schools (May 2009) (unpublished Ph.D. dissertation, University of Southern California), <http://digitallibrary.usc.edu/assetserver/controller/item/etd-Granger-2694.pdf;jsessionid=ED077734D5823849EBFB9477A3383C1D>.

²¹ *Serrano I*, 487 P.2d at 1243.

²² *Serrano I*, 487 P.2d at 1263.

²³ See Lawrence O. Picus, *Cadillacs or Chevrolets?: The Evolution of State Control Over School Finance in California*, 17 J. Educ. Fin. 33, 42 (1991) (explaining Assembly Bill 65).

²⁴ William A. Fischel, *Did Serrano Cause Proposition 13?*, 42 Nat'l Tax J. 468, 470 (1989).

²⁵ See William A. Fischel, *supra* note 24, at 469.

2.4 Failed reform efforts

Adding fuel to the fire, the state budget surplus rose to \$5.7 billion in 1978, with some predicting it would pass \$10 billion without Proposition 13.²⁶ This surplus was funded by inflation. As nominal incomes rose with inflation, the progressive tax system meant that a larger proportion of each taxpayer's income was taxed.

There are several theories about why legislators did not provide immediate relief to homeowners. One theory is that legislators could agree on neither the type of reform necessary – reform tied to income or reform without regard to any demographic variable – nor the fiscal impact that any changes would bear on the services government could provide.²⁷ Others argue that California could not both provide homeowner relief and come into compliance with the *Serrano* decisions at the same time.²⁸ Contemporary sources estimated the five-year cost of *Serrano* compliance alone to be nearly \$4.3 billion.²⁹ Regardless of the reason, legislators failed to provide relief. Between 1975 and 1978, there were 22 legislative proposals, of which only two minor reforms passed.³⁰ Meanwhile, homeowners suffered with a broken system.

It was a short journey from Californians' frustration to their collective demand for change that brought forward Proposition 13. As the legislature remained in deadlock on property tax reform, Howard Jarvis, leader of the United Organization of Taxpayers, joined forces with Paul Gann, leader of the citizens' group the People's Advocate, to champion the benefits of Proposition 13. Through their efforts, they gained more than twice the number of signatures necessary to qualify their 389-word property taxation measure for the ballot, despite the bipartisan opposition of nearly the entire Californian political establishment, including Democratic Governor Jerry Brown and future Republican Governors George Deukmejian and Pete Wilson.³¹

26 Daniel A. Smith, *Howard Jarvis, Populist Entrepreneur: Reevaluating the Causes of Proposition 13*, 23 Soc. Sci. Hist. 173, 183 (1999).

27 Jeffrey I. Chapman, *The Continuing Redistribution of Fiscal Stress: the Long Run Consequences of Proposition 13*, 17 (1998) (unpublished working paper, on file with the Lincoln Institute of Land Policy).

28 *Reply to Stark and Zasloff*, *supra* note 17, at 919 (noting that the Legislative Analyst commented that the legislature did not have enough money to fund both AB 65 and property tax relief).

29 *Reply to Stark and Zasloff*, *supra* note 17, at 921.

30 Jeffrey I. Chapman, *Proposition 13: Some Unintended Consequences*, 1998 Pub. Pol'y Inst. Cal. 3.

31 Daniel A. Smith, *supra* note 26, at 191.

Both sides raised millions of dollars to fund a media blitz. Proponents highlighted the impact of escalating property taxes on homeowners, and the opposition questioned the wisdom of cutting off the revenue stream of local governments, warning of the unintended consequences that might result. Local governments were especially wary of any proposal to reduce property tax. Although home prices escalated rapidly, single-family homes were only about one-third of the property tax base for most jurisdictions. As a single-roll state – where property is not differentiated by its purpose for taxes – a reduction in property tax applied to all types of property, even those that did not appreciate at the same clip as single-family homes. Yet, commercial and industrial property, which paid about half of all property taxes statewide, received the same tax reduction as homes.

Spurred on by the media attention, 69% of Californian voters cast their vote in the election, and the measure passed with 65% of the vote.³² Following the historic vote, the legislature had three weeks to resolve a variety of problems erupting from Proposition 13, such as how they would allocate the property tax generated and how the state would help local governments recover.

3 The Implementation of Proposition 13

Instructions on how to implement this seismic shift in California's property tax system are noticeably absent from the initiative. In a sense, the architects of Proposition 13 simply identified an end without prescribing the means. State legislators were forced to confront a measure that would almost immediately result in a reduction of local property tax revenue by about 50%.³³ Although taxpayers could rest a bit easier, local authorities saw significant limitations placed on traditional revenue streams and their ability to provide services to constituents.

Elected officials were tasked with devising a system that enacted the tenets of Proposition 13 without completely crippling local agencies that had grown dependent upon inflated property tax streams. The results of their efforts, Senate Bill 154 (SB 154) and Assembly Bill 8 (AB 8), came to serve as the foundation for California's present-day property tax allocation system. While the swift response granted temporary relief, the early decisions and concessions made by legislators put California on a path toward a financial system best characterized by chaos

³² Daniel A. Smith, *supra* note 26, at 174.

³³ California Performance Review, Government for the People for a Change, http://cpr.ca.gov/CPR_Report/Issues_and_Recommendations/Chapter_1_General_Government/Strengthening_Government_Partnerships/GG28.html (last visited March 21, 2011).

and inequity. The time is ripe for a modern renovation that restores local control in a manner that provides discretion to adapt to modern needs.

Given the limited amount of time allotted between the passage of Proposition 13 and the prescribed date of enactment set forth by the measure's text – three weeks – the legislature pushed through what was believed to be a short-term statute devised by a bipartisan working group comprised of Assembly and Senate leadership. Despite being viewed as a stopgap solution, SB 154 became a seminal piece of legislation. This initial response is held by some as the onset of an era in which the state became directly involved in delivering and financing local services.³⁴

The legislature then put forth AB 8 as a follow-up to SB 154. Legislators at the time came to view AB 8 as the long-term solution to the Proposition 13 dilemma. AB 8 took a more measured approach and set its sights on the process by which the growth realized within tax rate areas would be reallocated to local jurisdictions.

Since the legislature passed SB 154 and AB 8 as the implementing legislation of Proposition 13, the allocation levels and processes have remained frozen, despite significant changes in demographics and the variable need for services from local government linked closely to these demographic shifts. To resolve these issues, the state must harmonize Proposition 13 with its changing demographics by remedying allocation levels to account for the level of services needed in each area. Through modification of SB 154 and AB 8, policymakers stand to mitigate the consolidation of financial control at the state level by reinforcing principles of local governance and accountability. However, reform will not be easy.

3.1 SB 154

A sudden conversion to an acquisition-value property tax system understandably comes with repercussions. Proposition 13 resulted in an immediate loss of about \$7 billion in property taxes for local agencies throughout the state.³⁵ This amounted to 22% of their total budgeted expenditures.³⁶ With the state or federal government mandating many of their budgeted services, local governments faced a crisis. Given the rush to meet the approaching onset of demands for the fiscal

³⁴ Mark Baldassare, *When Government Fails: The Orange County Bankruptcy* 62 (1998).

³⁵ Valerie Raymond, *Surviving Proposition Thirteen: Fiscal Crisis in California Counties* 1 (1988).

³⁶ Paul Richter, *California and the American Tax Revolt: Proposition 13 Five Years Later* 24 (Terry Schwadron ed., 1984).

year in 1978 and the need to ensure the uninterrupted delivery of local service, the legislature assumed or reduced local matching obligations for several key programs, including Medi-Cal, Supplemental Security Income/State Supplemental Program (SSI/SSP), and Aid to Families with Dependent Children. The large influx of state bailout funds came from a general fund surplus and represented a temporary solution, not a long-term fix to the state's newfound property crisis. Specifically, the measure provided 90% funding to local governments and washed away remnants of the revenues generated in years past.³⁷

However, one critical aspect of SB 154 proved to have major implications for the future of California's property tax allocation system. Given the infeasibility of concisely reconciling the vast differences inherent in the state's pre-Proposition 13 property tax system, the legislature opted to employ one of the quickest and easiest solutions. By utilizing an "as you were" approach, the state froze property allocation shares based on historical funding trends.³⁸ This meant that if city A received a larger share of state aid than city B because its pre-Proposition 13 property taxes were higher, and therefore suffered a more devastating blow from Proposition 13, city A would continue to receive a larger share. However, that larger share would now come from the 1% cap on property taxes implemented by the passage of Proposition 13. Although escalators and other factors were eventually incorporated, SB 154 generally set the base for what local agencies would receive under the Proposition 13 tax regime.

3.2 AB 8

With state surpluses in the period leading up to Proposition 13 being the result of escalating property taxes, there was no justifiable reason to believe that the state would continue to enjoy such fiscal success. Therefore, there could be no permanent bailout system that resembled the sweeping rescue efforts put forth by SB 154. Given the uncertainty of the future financial landscape, the legislature passed AB 8 in 1979 and dubbed it to be a long-term solution to the chaos enacted by Proposition 13.

AB 8 made several changes that both incorporated and corrected portions of SB 154. For instance, the state completely bought out local shares of programs

³⁷ John J. Kirlin, *The Impact of Fiscal Limits on Governance*, 25 *Hastings Const. L.Q.* 197, 201 (1998).

³⁸ David Elledge, *Demystifying the California Property Tax Apportionment System: A Step-by-Step Guide through the AB 8 Process 3* (2006), available at <http://www.sccgov.org>

such as Aid to Families with Dependent Children. Additionally, the state officially froze the local property tax share rates. Coupled with these rates freezes were stipulations that factored proportions of the money received via the bailout into the new funding base that local agencies were set to receive.

For example, cities received 82.91% of their bailout block grants as an addition to their new property tax share, special districts received 95.24% of the block grant as an add-on to their property tax share, and counties received 100% of their 1978–79 block grant as an add-on to their “base.”³⁹ Local agencies received this boost in funding as a result of a shift of about one-third of local school property tax shares. The state then backfilled the money diverted away from the school.

In addition to the base share augmentations, AB 8 also adjusted the use of a “tax rate area” system that paid respect to local boundaries when allocating property tax revenue growth. Tax rate areas are those areas governed by a shared set of local agencies. SB 154 crossed geographical boundaries and, presumably, allowed low-growth areas to benefit from the gains achieved by neighboring moderate-growth or high-growth areas. The AB 8 system guaranteed that local governments could expect to receive their fair share of new growth within their jurisdiction.

Although tax rate areas predate Proposition 13, tax rate areas became key vehicles for the narrowing of complexities and the determination of revenue growth allocation. Instead of attempting to normalize the pooled gains on the county level, the localized use of tax rate areas further emphasized the historic shares of agencies servicing a locality and magnified the historical inequities written into SB 154. In other words, the bill did little to smooth out any disproportionate allocation present prior to the passage of Proposition 13. Given this oversight, disparities intensified and were increasingly apparent as local governments felt the pressure of fiscal restraint.

Lastly, AB 8 provided a critical scapegoat clause to be used by state officials as they saw fit. What is referred to as the AB 8 “deflator” stipulated that, in periods when state revenues were lethargic, local governments were to relinquish a portion of the state revenues they normally received to ensure that state-funded programs could continue to function.⁴⁰ For most localities, this was the time when they needed state aid the most. Eventually the AB 8 deflator was removed via creative accounting procedures on the part of the State.⁴¹ By shifting certain portions of property tax revenues, the state was able to secure consistent blocks

³⁹ David Elledge, *supra* note 38, at 15.

⁴⁰ Valerie Raymond, *supra* note 35, at 11.

⁴¹ See David Elledge, *supra* note 38, at 34, 35.

of revenue for cash flow and program/system financing purposes. Nevertheless, the inclusion of the deflator set precedent for local agencies being vulnerable to funding cuts during times of hardship on the state level, making this an area where the state seemingly showed the most foresight while dealing with the implementation of Proposition 13.

Over time, AB 8 has undergone numerous changes. Regardless, the present-day tax allocation system that exists in California closely resembles the AB 8 allocation system. Cities continue to receive the shares that they did when AB 8 froze the SB 154 levels for local agencies with the bailout inflators added on. While the state's economy, demography and other factors have changed greatly, AB 8 has held steadfast as an almost unchanging and seemingly incorrigible system of organized chaos. Despite its local enactment, the property tax system in California is still – for better or for worse – dominated by the state. Until action is taken to combat the problem and return decision-making authority to the local level, California's property tax allocation system will remain riddled with inequities, blind to need and operating in a manner antithetical to the greater good of California's citizens.

Lenny Goldberg, from the California Tax Reform Association, said it best when he wrote that in the wake of Proposition 13 California has become a state in “survival mode,” simply “staving off disaster instead of planning for the future.”⁴² While Goldberg's assertion is directly critical of Proposition 13 itself, the same criticism readily applies to the flawed implementation of Proposition 13 and its impact on local agencies.

4 The Consequences of SB 154 and AB 8

Signs of mounting inequity in the property tax allocation system emerged shortly after the passage of AB 8. The loss of local control over local finances meant that local governments were held hostage to state budgetary problems. Consequently, local governments were forced to undertake substantial adaptations to respond to fiscal limits, resulting in a “growth of arcane finance techniques.”⁴³ Together, the loss of local control and the turn to exotic financing to fund services has created an unsustainable system of government.

⁴² Lenny Goldberg, *Taxation with Representation: A Citizen's Guide to Reforming Proposition 13 1* (1991).

⁴³ Jeffrey I. Chapman, *supra* note 30, at 15.

4.1 The Loss of Local Control

The legislation that implemented Proposition 13 resulted in a loss of local control to pursue local interests by making localities more reliant on state funding – and, subsequently, state decision-making – and less fiscally autonomous. Local governments as political subdivisions of the state are not sovereign entities. As the Supreme Court noted in *Reynolds v. Sims*, “they have been traditionally regarded as subordinate governmental instrumentalities created by the state to assist in the carrying out of state governmental functions.”⁴⁴ While this may be true, local governments are the political entities most capable of adapting local services to changing local needs. This is the fundamental principle of subsidiarity – that matters ought to be handled by the smallest, lowest, or least centralized competent authority. The measures passed in the wake of Proposition 13 resulted in a loss of local control that has centralized power in an entity that is not the most efficient for responding to local needs.

Following Proposition 13, the state took on an increasing amount of responsibility to bail out local governments so these governments could continue providing services. Additionally, under AB 8, the state created a formula – based on the property tax allocation shares – that reduced the level of assistance the state provided to localities if state revenues did not meet expectations. For example, in 1984 a reduction in the vehicle license fee at the state level meant that the state revenues were lower than expected. The result was a loss of \$2 million in state bailout in Alameda County alone.⁴⁵ The inequity was that, at the same time, the much larger Orange County managed to escape with less than \$300,000 in losses.⁴⁶ According to Valerie Raymond of the Berkeley Institute of Governmental Studies, these “discrepancies were . . . justified by offsetting amounts that the state paid for health and welfare programs.”⁴⁷ Such a rationalization demonstrates how the allocation system has made matters far more complex. Instead of linking funds to needs, local agencies have seen their fiscal health become linked to historic property tax shares and other streams of funding from the state level. The consequence of the loss of local autonomy is a greater disconnect between decision makers and distinctive local conditions.

The inequities of AB 8 are not exclusive to times of economic hardship; the inherent problems were not fully erased by growth. While the assessment values

⁴⁴ *Reynolds v. Sims*, 377 U.S. 533, 575 (1964).

⁴⁵ Valerie Raymond, *supra* note 35, at 12.

⁴⁶ *Id.*

⁴⁷ *Id.*

of property might grow, the shares of property tax allocated to localities remain the same. Therefore, neighboring localities might receive drastically different shares of property tax forevermore, not as a result of need, but rather because of a formula based on historical trends. If a local jurisdiction received a larger share of property tax when the system was designed, it will continue to receive a larger share of the property tax regardless of changed circumstances. An extreme example of the inequity of this system is that of a cemetery district which received a higher-than-normal rate of property tax to pay for a street overlay on its property during the years that set the property tax allocation shares. Under the current system, the benefits of its “temporary” increase would continue perpetually. Such inelastic variation is alarming and directly attributable to the frozen shares manifested under SB 154 and ossified by AB 8.

When addressing the allocation system in California, it is important to be mindful of the zero-sum nature of the funding pool. For every winner, there must be a loser. For this reason, it is difficult to muster individual political will to bring about much needed change. Many elected officials view the problem through a narrow lens, seeing allocation shares only as a local issue and driving them to approach reform in a manner that benefits their jurisdiction, rather than the greater good of the entire state.

The original SB 154 system pooled growth on a countywide level and then redistributed that growth proportionally. This approach only lasted for a year before an increasing uproar expressed the desire of localities to capture all growth within their local boundaries. Under the SB 154 formula, a high-growth city faced disincentives because its growth would ultimately end up supplementing the efforts of low-growth cities. While this was not perceived as a fair approach, Peter Detwiler suggests that the preservation of this system may have resulted in a different set of land-use decisions that would have emphasized smart growth over generating revenue.⁴⁸ While there is no guarantee that this would have been the result, retaining the system of countywide pools to be redistributed would certainly have resulted in a different type of growth.

4.2 A turn to exoticism and the “Fiscalization of Land Use”

Under the new regime of state control over the allocation shares that localities receive, local governments were forced to turn to exotic financing techniques to

⁴⁸ Interview with Peter Detwiler, Senate Local Government Chief Consultant, in Sacramento, California, April 2008.

cover their shortfalls. Since Proposition 13 mandated that cities, counties, and special districts impose “special taxes” only with the approval of two-thirds of voters, local governments became imaginative in how they raised revenue.

In 1982, the California Supreme Court determined that “special taxes” were taxes earmarked for a specific purpose, whereas general taxes were those levied for general governmental purposes.⁴⁹ The result was twofold. First, taxpayers were no longer able to attribute taxes they paid to benefits they received. Under the Hamilton “benefit view” of taxation, taxpayers would reject any form of taxation that they could not trace to a benefit they received. Second, facing threats of cuts to services such as fire, police, and library services, cities and counties throughout the state resorted to a more exotic blend of taxes and “fees” that did not require voter approval. From increasing transient occupancy taxes, business license taxes, and utility user taxes to developing innovative bond financing techniques, local agencies resorted to new types of funding streams that would likely be unnecessary in a less hostile fiscal environment.

Michael Coleman, an expert on California local government finance, compiled numbers from the State Controller’s web site, and the outcome is telling. The numbers show an increasing blend of exotic taxes and fees once localities could no longer rely on the property tax as a revenue source.⁵⁰ Although there has been a steady decrease in the amount of financial support that California’s local agencies receive from the state and from the federal level, there has been a noticeable rise in the percentage of revenues derived from service charges and other taxes and assessments. Coleman’s numbers directly show the growth in the use of utility user taxes, transient occupancy taxes, and business franchise taxes.

Berkeley is one city not bashful about exposing the pressing need to levy non-traditional taxes. Experiencing declining revenues immediately after Proposition 13’s implementation and stagnant or declining revenues since the early 1990s, Berkeley has been forced to increase fees and taxes in a number of creative ways.⁵¹ In the year of Proposition 13’s enactment, revenue from other sources – sales, transient occupancy, and business license taxes – was less than one-half of that generated by the property tax. In less than 15 years, Berkeley had adapted

⁴⁹ *City and County of San Francisco v. Farrell*, 32 Cal. 3d 47 (1982).

⁵⁰ See *infra* Appendix; see also Robert W. Wassmer, *California’s State and Local Revenue Structure after Proposition 13: Is Denial an Appropriate Way to Cope?*, in *State and Local Fiscal Policy: Thinking Outside the Box* 98 (Sally Wallace ed., Edward Elgar Publishing 2010).

⁵¹ See *City of Berkeley Planning and Dev. Dept., Conditions, Trends and Issues: Socio-economic Conditions: Fiscal Conditions*, <http://www.ci.berkeley.ca.us/contentdisplay.aspx?id=1992> (last visited March 4, 2011).

these taxes and generated almost twice the revenue from them as from property taxes. Non-enterprise special districts have shown similar behavior, with revenues attributable to fees growing from 7% in 1978 to over 40% in 1996.⁵² Business license taxes, franchise taxes, real property transfer taxes, and transient lodging taxes grew over 400% during the same timeframe.⁵³

The turn toward “the fiscalization of land use” was a subtle measure to cover the shortfall created by Proposition 13 – albeit one with devastating long-term effects. The “fiscalization of land use” is the preference for land-use decisions that generate tax revenues, such as big-box stores and higher-end residential areas.⁵⁴ Cities and counties maximize revenues by approving higher-end residential and retail development projects. Both types of projects are far more lucrative than low-income or moderately priced single-family housing, industrial development, or office development. The concentration on revenue-generating projects following SB 154 and AB 8 is an unfortunate reality: projects that generate greater revenue receive more emphasis than even necessary projects that bring in less revenue. Increasingly, localities have deferred new projects – especially capital developments – as a tactic to alleviate the fiscal pressure on existing services. AB 8 introduced a new element of competition to the property tax allocation fray. The “long-term solution” to Proposition 13 indirectly sparked the chase for revenue and continues to drive local officials toward decisions that may not be the best-suited for their constituencies. While building low-income housing is usually viewed as an honorable and important undertaking for local governments, it is difficult to prevent the allure of higher revenue-generating ventures clouding the minds of officials.

Former Assembly Member Darrell Steinberg introduced several bills in hope of stripping some incentives away from cities that make poor land use choices in hope of generating more sales tax revenue.⁵⁵ Steinberg’s efforts would have shaved certain portions of the sales tax and diverted those funds to the state. In exchange, local agencies would be guaranteed a larger share of the property

52 Terri A. Sexton et al., *Proposition 13: Unintended Effects and Feasible Reforms*, 52 Nat’l Tax J. 99, 107 (1999).

53 Michael A. Shires, *Changes in State and Local Public Finance Since Proposition 13, 1999* Pub. Pol’y Inst. of Cal. 18, available at http://www.ppic.org/content/pubs/rb/RB_399MSRB.pdf.

54 See, e.g., Paul G. Lewis & Elisa Barbour, *California Cities and the Local Sales Tax 68–69* (1999).

55 Press Release, Assembly member Darrell Steinberg, Steinberg and Campbell Announce Joint Legislation: Historic Bipartisan Plan to Restructure Local Gov’t Fin. (February 27, 2003), available at <http://www.californiacityfinance.com/AB1221pr.pdf>

tax base. While these efforts were both daring and innovative, each fell victim to the reality that elected officials are charged with the duty of protecting the interests of their constituents. Cities have become accustomed to their creative revenue-generating efforts. When proposals aim at undercutting those efforts – even if for a cause such as providing better incentives – they reject them. Cities have entrenched themselves with alternative methods to generate revenue growth that cannot be generated via property tax revenues.

Additional examples highlight the inhibiting, sometimes crippling, elements of property tax allocation in California. Amador County saw an exponential increase in prison fees that almost froze its operations; Kings County had criminal justice expenses that far exceeded its total property tax share; and Orange County faced a \$90 million deficit in the 1987–88 fiscal year.⁵⁶ Meanwhile, big-box retailers and strip malls became king in California, as long as they continued to deliver high amounts of sales tax. Spending money to deliver services – both those deemed mandatory and those deemed necessary – was the easy part. Yet, raising the revenue to pay for these expenses became increasingly difficult. The examples listed showcase the inability of the AB 8 formula to adjust with growth or facilitate the absorption of sharp economic jolts. The loss of fiscal control at the local level forced local governments to turn to survival measures that ultimately have changed the face of development in California.

5 Proposals for Reform

Until reform is undertaken to decentralize state control over property tax allocation and to increase local autonomy, California's property tax system will remain inefficient and blind to need. It will support short-term growth that is antithetical to the long-term greater good of California.

To have any substantive or substantial impact on the chaos that is California's property tax system, it is essential that any potential changes to the allocation process be systemic. The zero-sum nature of property tax allocation gives rise to the narrow approach so often pursued in the past by legislative reformists. While individual lobbies for cities, counties and special districts will play important roles in achieving comprehensive change, the purely local interests of these entities would lead to a "tragedy of the commons" as each vies for its cut of the

⁵⁶ Valerie Raymond, *supra* note 35, at 19.

property tax, contributing to the growing disparities that are deeply embedded in the AB 8 system. Achieving any of the following proposed policy alternatives requires political leadership and cooperation from a wide breadth of stakeholders at the state and local levels.

The hope is that, in each circumstance, a degree of local power is restored by placing power at the regional level. This realignment will lead to more accountability, greater flexibility, and allocations that are responsive to the modern needs of local governments. Ultimately, the effect will be either an overall reduced tax rate or a greater acceptance of higher taxes by the California populace.

5.1 Regional property tax allocation boards

The first reform proposed takes aim at the outdated and state-mandated tax allocation system by creating regional property tax allocation boards charged with divvying up the property tax shares each locality receives from Proposition 13 money. In most instances, the impulse of localities is to resist a shift toward regional control. Local governments already have so many constraints that they fear relinquishing the discretion they do possess. In the case of property tax allocation in California, this is not the case. Since the state mandates what each locality receives, a shift to a regional level is actually a step in restoring local control.

Local government theorists provide helpful insight for how to construct a regional institution. Local government theorist Gerald Frug, an advocate for decentralized politics, discusses regional governance as needing inter-local cooperation, rather than a new regional institution.⁵⁷ Frug posits that the most desirable institution is a regional legislature with representatives from each locality protecting their interests. Frug argues that “the demand for regional equity and the protection of local autonomy conflict with each other, and it is disingenuous to pretend otherwise.”⁵⁸ Therefore, “[w]hat is needed instead is an institution that will permit the region’s cities to work together to advance regional interests.”⁵⁹ Richard Briffault, however, advocates for a “mixed strategy” that would promote a regional institution for regional issues, but leave local governments charged with local decision-making. Briffault finds Frug’s

⁵⁷ Gerald E. Frug, *Beyond Regional Government*, 115 Harv. L. Rev. 1763 (2002).

⁵⁸ *Id.* at 1780.

⁵⁹ *Id.* at 1790.

regional legislature unrealistic for a regional agenda. He notes that, “[e]nlightened self-interest might lead some localities to see the benefits of cooperation, but the limited capacity of any one locality to resolve regional problems may discourage even the enlightened locality from cooperating.”⁶⁰ Briffault advocates the principle of subsidiarity, stating that “[r]ather than consolidate all local government powers and responsibilities at the regional level, only those functions necessary for [regional] governance should be shifted to regional institutions.”⁶¹

While Frug discusses a regional legislature in the context of regionally important issues, such an institution is impractical for a regional property tax allocation board. Inter-local cooperation that permits each locality to send a representative to protect its interest would not occur with an institution designed to divvy up tax revenue. The zero-sum nature of property tax allocation encourages each locality to vote for itself to receive as much revenue as possible regardless of need. A locality would have a harder time advancing a regional agenda to the detriment of its own interests. However, Frug’s complete regional governance is a call for a paradigm shift in California in a scenario where it is not required. Therefore, Briffault’s “mixed strategy” model is the most appropriate for a regional property tax allocation board, although with some modifications. A regional model will lead to greater accountability, efficiency and effectiveness in property tax allocation.

Several factors must be considered before creating regional property tax allocation boards. The main ones are a regional board’s jurisdiction and composition, as well as the frequency with which they recalculate tax allocations. The regional property tax allocation board should have jurisdictional lines that follow the boundaries of the electoral districts. The regional board should be composed of members that are both regionally elected and nominated for state appointment by localities – an approach that would incorporate principles from both Frug and Briffault. Finally, the property tax allocation boards should adjust the shares of local governments every 10 years to correspond with the national census. Each of these factors merit further exploration by the legislature in consultation with local governments to adequately determine the best approach. However, these measures will provide the structural protections necessary to incorporate a local perspective while advancing regional interests.

⁶⁰ Richard Briffault, *The Local Government Boundary Problem in Metropolitan Government*, 48 *Stan. L. Rev.* 1115, 1150 (1996).

⁶¹ *Id.* at 1165–66.

5.1.1 Jurisdiction

Determining the jurisdiction of the regional property tax allocation board is the first step toward change. Creating new regional boundaries is unnecessary, because there are regional jurisdiction lines already in place. The quick and dirty approach is to have a regional property tax allocation board for each county. There are 58 counties in California and they are already responsible for property-tax collection, along with several other regional services such as local courts, maintenance of public records, and elections.⁶² The jurisdiction of a regional property tax allocation board might also follow the electoral district lines of the California State Assembly (80 districts), California State Senate (40 districts), or the US Congress (53 districts).⁶³ Until recently, the legislators representing those jurisdictions were responsible for drawing the jurisdictional lines. However, California has shifted the responsibility of drawing district lines to a Citizens Redistricting Commission.⁶⁴ The Commission is tasked with drawing the district lines, “in conformity with strict, non-partisan rules designed to create districts of relatively equal population that will provide fair representation for all Californians.”⁶⁵ By following any of the types of electoral districts, the regional property tax allocation boards would ensure that their jurisdictions have a relatively uniform population, whereas using the county lines would make their jurisdictions range in size from just over one thousand people in Alpine County to more than ten million in Los Angeles County.

When an issue arises that is larger than the decided jurisdiction of each board, regional boards must work together to protect their collective interests. Doing so requires a level of inter-regional cooperation. For example, large areas of California are prone to wildfires. If a regional board in one area allocates a large amount of money for fire abatement, there is a “free rider” problem from nearby regions. By creating a special purpose district that covers the wildfire prone

⁶² California counties, Fact Sheet, <http://www.csac.counties.org/default.asp?id=2> (last visited March 21, 2011).

⁶³ California Voter, California Map Series, <http://www.calvoter.org/voter/maps/index.html> (last visited March 21, 2011).

⁶⁴ Proposition 11: Official Title and Summary, <http://www.voterguide.sos.ca.gov/past/2008/general/title-sum/prop11-title-sum.htm> (last visited March 14, 2011); Proposition 20: Official Title and Summary, <http://www.voterguide.sos.ca.gov/propositions/20/title-summary.htm> (last visited March 14, 2011).

⁶⁵ California’s FIRST Citizens Redistricting Comm’n, <http://www.wedrawthelines.ca.gov> (last visited March 13, 2011).

area, the regional boards ensure that these inter-regional issues are addressed. However, they must collaborate to determine the appropriate revenue each board will contribute to the special district's function. This can be done based on a formula that accounts for any number of factors – number of individuals protected, the level of threat etc. – in each jurisdiction.

Regardless of the factors used to determine allocation, the regional boards will need a mechanism to work together. In those instances, the regional boards need a collaborative system, a task that can be accomplished by contract or by state decree. The benefit to regions negotiating with one another contractually is that it retains a level of local control whereas a state decree re-imposes a central authority.

5.1.2 Composition

Once the jurisdiction is determined, the challenge is to compose a property tax allocation board so that its members appropriately and fairly represent localities. There are risks and benefits to the structural components employed in this composition.

The first component to consider in constructing a regional property tax allocation board is whether its members should be appointed or elected. Rather than making a property tax allocation board with members made up of strictly elected or appointed, the regional boards should incorporate a “mixed” strategy of both appointed and elected officials. This addresses the problem of regionally elected officials favoring more populous areas to ensure reelection or appointed members that are less accountable to the public. A “mixed strategy” ensures accountability while also not undervaluing the less populous areas of a jurisdiction.

Without election pressures, appointed members on the property tax allocation board are less susceptible to special interest lobbyists. There is no reason for an appointed member to worry about funding a future campaign or ingratiating themselves with voters. To be fair, this is a double-edged sword. Appointed members will also be less accountable to the public for their decisions. To encourage local participation in the appointment process, they should be nominated for state appointment by localities. Allowing the state government's involvement – while taking away a degree of local control – provides the opportunity to weed out individuals who are placed on the board to serve only the interests of the locality that nominated them.

Each regional board should also incorporate elected officials. As Briffault notes, “if regional government is to provide a basis for democratically accountable

regional decision-making, it must have its own elected officials.”⁶⁶ Elected officials have the legitimacy that comes from a popular election and are better positioned to have their thumbs on the regional pulse. Appointed members, on the other hand, might feel beholden to the locality that elected them, thereby skewing the process into a Frug-like regional legislature. Regionally elected members will infuse the board with a truly regional perspective while reducing the significance of local boundaries. Regional elections offer an opportunity for region-wide deliberation, as well as popular participation in matters of regional significance, while maintaining political accountability.

5.1.3 Voting

How the regional board allocates votes is critical in determining the fate of its component cities. Two aspects of voting are particularly important: the voting power of individual board members and the voting requirement to pass a binding decision. Ideally, the regional board would advance only regional interests for the benefit of the entire region. However, structural measures should be in place to account for the population of larger cities while ensuring that smaller cities are not ignored. Both voting power and the voting requirement are important factors in the success or failure of a regional board in fairly representing localities while advancing regional interests.

The voting of individual board members depends on whether they are elected or appointed officials. If officials are elected, the US Constitution demands weighted votes based on population. In the landmark decision of *Reynolds v. Sims*, the US Supreme Court held that the Equal Protection Clause requires adherence to the one-person, one-vote principle at the state level.⁶⁷ The court extended this rule in *Avery v. Midland County* to the election of county government officials.⁶⁸ In *Board of Estimate v. Morris* the court struck down a scheme where the boroughs of New York were each represented by one vote on a board. The court found that this representation did not provide voters equal protection.⁶⁹ The court held that, “the relevant inquiry is whether the vote of any citizen is approximately equal in weight to that of any other citizen.”⁷⁰ Where a regional board has elected officials

⁶⁶ Richard Briffault, *supra* note 60, at 1167.

⁶⁷ *Reynolds v. Sims*, 377 U.S. 533 (1964).

⁶⁸ *Avery v. Midland*, 390 U.S. 474 (1968).

⁶⁹ *Bd. of Estimate v. Morris*, 489 U.S. 688 (1988).

⁷⁰ *Id.* at 701.

representing localities that vary in population, and the official only has one vote, the votes of citizens from more populous cities are diluted. Regionally elected board members with one vote each would not face this problem because each official is representing the whole region rather than a particular city.

The question becomes whether the principle of one-person, one-vote, applies to appointed officials. In *Sailors v. Board of Education*, the US Supreme Court answered this question.⁷¹ The court found that where the officers are non-legislative and unelected, the principle of one-person, one vote, does not apply. The appointed officials could therefore be given a different number of votes. Distributing votes by taking into account relevant factors (population size, property tax contribution, services provided, and others) is thereby possible. This formulaic approach allows for a system that can account for nuances among the localities. Each appointed member could therefore represent the locality that nominated them for the position, and their voting power would vary based on the city's size and needs.

The next component is the threshold number of votes required to make a binding decision. There are several options available: unanimity, majority, or supermajority. In this case, the supermajority requirement is the best mechanism for achieving a functional regional board.

There is no circumstance in local, state or federal politics that requires a unanimous vote to come to a decision – and for good reason. With so many members representing conflicting interests, a unanimity requirement would be nearly impossible to achieve. Including appointed officials approved by the state legislature and regionally elected board members would hopefully mean that the board would work together for the collective interest of the region. However, there will still be conflicting views on what is the best allocation of property tax shares.

A majority vote might make sense, depending on the amount of population represented by the majority. A majority that represents most of the population would be a threshold that would advance a regional plan more quickly. However, the possibility remains that a majority vote represents less than the majority of the population. Imagine, for example, a region that includes only Los Angeles County. In Los Angeles County, there are over 10 million people spread throughout 88 municipalities.⁷² If all of the regionally elected officials vote for a regional tax allocation plan, the proponents would only need one appointed official to

⁷¹ *Sailors v. Bd. of Educ.*, 387 U.S. 105, 111 (1967).

⁷² County of Los Angeles Chief Executive Office, *Cities Within the County of Los Angeles*, <http://ceo.lacounty.gov/forms/09-10%20cities%20alpha.pdf> (last visited March 21, 2011); US Census Bureau, *State and County QuickFacts*, <http://quickfacts.census.gov/qfd/states/06/06037.html> (last visited March 21, 2011).

favor the plan for it to pass. If the official appointed by the City of Los Angeles, which has half of the population of the region, was opposed to the measure, any of the 87 other municipalities could cause the plan's implementation.

A qualified majority voting system that requires a consensus by population size would provide adequate safeguards. Local government theorists have suggested importing elements from the European Union into the regional governance context, in efforts to provide these safeguards.⁷³ In the European Union, the council makes decisions by a qualified majority voting system. The European Union defines a qualified majority by allocating votes proportional to a member's population, and then requires a minimum number of votes before a policy is adopted. There are clear differences between a regional single purpose government and the European Council, but qualified majority voting would address the problem of the City of Los Angeles being outvoted by a coalition of small cities representing a fragment of the population.

5.1.4 Frequency

The final component to constructing a regional property tax allocation board is how frequently the board should reallocate shares of property tax among its localities. Under the status quo, property tax allocation is based on a formula that incorporates 30-year-old attributes of localities. As explained above, the system is antiquated. However, re-allocating shares too frequently would not allow localities to adjust to the new conditions, nor would it allow the board time to measure, assess, and incorporate changing factors.

Reassessment of the property tax allocation should take place every 10 years to correspond with the national census. Each decade the regional property tax allocation boards would reassess the allocation rates for all local agencies receiving property tax revenues. The 10-year interval allows for adjustments based on population growth and service needs related to changing demographics. Using a 10-year interval, measurements of need would identify and exclude any outlier years.

5.1.5 Restoring control and reducing the budget

A properly constructed regional property tax allocation board serves the goals of returning significant control to localities while reducing the budget. While

⁷³ Gerald E. Frug, *supra* note 57, at 1766.

not truly returning to a localism model where local governments are fully autonomous, it alleviates the inefficiencies of centralized state control, while remaining true to the intent of Proposition 13. The benefit of regionalism is that it allows for the consideration of regional problems, formulation of regional solutions, and implementation of those solutions at a level of governance that remains accessible to taxpayer participation. The body assembled for each county would be charged with taking an objective approach to assessments and growth allocations. All stakeholders would need adequate representation and the outcomes could be subject to approval at the state level, if necessary.

Within this model, cities would find themselves better able to articulate their needs. Greater control over property tax allocation better positions cities to spend their money efficiently. The flexibility afforded reduces the odds that a city will turn to fees or special taxes to cover shortfalls. Gains toward equity, within the county, could actually be made if the operations of the regional board are formulaic, objective, and not politically driven. While it is unrealistic to assemble a body that is purely objective and able to act in full accordance with the spirit of regionalism, the structural protections in place will prevent the regional board from being hijacked by purely local interests. Together, the appointed members and regionally elected officials can advance a regional plan that restores equity at the local level.

5.2 Special district funding

When the state fashioned its implementation of Proposition 13, special districts were swept into the legislative package along with cities and counties. Since then, special districts – units of local government that provide specific services – have received an allocation of property tax from the State. California’s inclusion of special districts as direct recipients of property tax revenue obscures the budget process for taxpayers and indexes service levels to outdated needs.

One strategy for improvement is to de-fund special districts from property tax. To visualize the need for de-funding special districts, we can simply observe the lay of the land in Alameda County. The City of Berkeley, with a population of more than 100,000 people, has approximately one paid firefighter per 1000 residents in the city.⁷⁴ Compare that to Emeryville, a city with slightly fewer than

⁷⁴ E-mail from Michael Coleman, Principal Fiscal Policy Advisor, League of California Cities, to Dontae Rayford, Fellow, California State Assembly (May 6, 2008) (on file with author)

7000 residents, which has nearly four paid firefighters per 1000 residents in the city.⁷⁵ One can travel farther south to Union City, which has a population of more than 66,000, with less than one paid firefighter per 1000 residents.⁷⁶ While there very well may be unique circumstances that account for the variation in fire protection levels, it is important to acknowledge that these levels are not fully based on need. Instead, these levels are linked to historic service delivery methods and property tax shares. De-funding special districts completely would inevitably lead to a large portion of that reclaimed money going right back to special districts.

But who is best positioned to administer how special districts are funded – the state, the special districts, or a regional entity?

One model of distribution is to retain power centrally at the state level. To ensure that the status quo changes, one method to have funds allocated based on local need is to distribute property taxes as uniform shares depending on the type of services offered within a jurisdiction. This model maintains state control, but creates equity in how property taxes are allocated. While special districts might receive their funding by divvying up property tax based on the number of residents served, this model has complications. The costs of services may vary based on the geography (for example, rural fire protection as compared with urban fire protection). Costs may also vary depending on the type of service provided (such as mosquito abatement as compared with water sanitation). Certainly, it can be imagined that some communities may value a higher level of service over another depending on the local needs – a local value preference not captured by a uniform system. While an efficient system for administering property tax, in practice it turns out this is not the most efficient model for distribution.

Another option is to permit special districts to re-allocate the funds. This presents several problems. Predominant among them is that special districts are mostly single-purpose entities. Nearly 85% of special districts exist to perform a single function.⁷⁷ The incentive for each special district, therefore, is to receive as much funding as possible. In a zero-sum game, this is the wrong incentive. One might optimistically hope that the money would be allocated in appropriate ways to ensure critical service delivery to citizens. Unfortunately, it is hard

[hereinafter Michael Coleman e-mail interview]. See generally Michael Coleman, California Local Government Finance Almanac, <http://californiacityfinance.com> (last visited April 10, 2011).

⁷⁵ Michael Coleman e-mail interview, *supra* note 74.

⁷⁶ *Id.*

⁷⁷ California Special Districts Assoc., The Facts About Independent Special Districts, <http://www.cstda.net/images/stories/membership/specialdistrictsfactsheetwnewaddress.pdf> (last visited March 21, 2011).

to picture a special district relinquishing its share to ensure that another entity receives enough funding. The only positive aspect of this purely local model is that it frees up funds that can be redistributed. But it is easy to imagine a “tragedy of the commons” scenario with such limited resources.

The third option is to have a regional model. As discussed previously, regional property tax boards will have the power to reallocate property taxes. With nearly 2300 special districts it is impractical to have each one represented at regional property tax board meetings when there are only 481 cities and 58 counties.⁷⁸ Special districts would overwhelm meetings with their requests for funding. A better regional system would be to have cities and counties take responsibility for funding their special districts. Cities and counties would have the flexibility and the incentives to ensure that their jurisdictions receive the proper level of service delivery. Stripping property tax shares from special districts in the interests of providing greater flexibility to local decision makers will lead to more efficiency and greater accountability. The newly stripped funding could be partially used to contract for services with special districts based on the needs of a respective city or county. So a fire district previously receiving 15% of the property tax in the area that it serves would see that guaranteed money redirected to the appropriate local agency – city or county depending on whether the provided service is for residents of the city or multiple cities. That agency would then have the option to, for example, contract for fire services at 10% and dedicate the remaining 5% to some other unmet need in the community.

There are several benefits to de-funding special districts and giving power to regional property tax boards, including a more efficient budget and greater accountability. The flexibility of allowing local governments to rededicate funds means that they would be less reliant on special fees and bonds. In the end, this will reduce the overall tax burden. Additionally, by giving cities and counties the power over the services provided within its boundaries, voters are better positioned to hold their local leaders to account for city and county administration. In administering their respective budgets, there may be some interest by city and county officials in not allocating any money to special districts given the potential for special districts to have independent revenue streams (such as fees and service charges). Yet, if special districts are forced to raise fees or service charges, city and county officials will be held to account by voters in the next election cycle. The same effect is felt if city and county officials shift more property tax to special district services to reduce fees and service charges because local leaders would be forced to reduce other critical services to pay for them. City and county

78 *Id.*

officials would have a direct impact on the local services that their residents receive. With increasingly undedicated funding, officials would have the freedom necessary to take more effective and creative approaches to service delivery. The flexibility will allow local leaders, as well as the people they represent, to have greater authority to determine which services deserve more or less funding.

6 Conclusion

Property tax revenues are a zero-sum game. If you are unable to increase revenue, you cannot give local agency A more money without taking money from local agency B. Although taxation in California is generally consistent with the taxation levels in large states throughout the nation,⁷⁹ there seems to be a lingering fear that raising taxes will result in an erasure of the safeguards protecting Californian taxpayers. As Governor Jerry Brown attempts to overhaul California's financial future, revisiting the way California uses the money it currently distributes is in some respects more favorable than advancing an agenda filled with tax hikes. By no means is it unprecedented to take issues with the AB 8 process. In 1999, Assembly Bill 676 formally stated that the property tax allocation in the state was "seriously flawed."⁸⁰ Many have proposed measures that would help to remedy some of the underlying problems plaguing the process. Yet, none of these measures have been developed substantially and few would take to task the entire system. Nevertheless, one of the most important themes in this discussion is the continuous call for more local control and greater accountability. Proposition 13 gave the state an opportunity to "save" local governments, but in the process, it implemented a system that maintains a loss of local autonomy and creates greater taxpayer confusion.

One can also directly call into question the effectiveness of the historical-share formulas that govern the AB 8 allocation system. Although, in some respects, the localizing of growth allocation has worked to erase some inequities locked in by the formulas,⁸¹ there is still reason to believe that these rigid shares disadvantage

⁷⁹ See *Just the Facts: California's Tax Burden*, 2008 Pub. Pol'y Inst. Cal., available at http://www.cotce.ca.gov/documents/documents/JTF_TaxBurdenJTF.pdf; Tax Foundation, *State and Local Property Tax Collections Per Capita by State, Fiscal Year 2008*, <http://www.taxfoundation.org/taxdata/show/251.html> (last visited March 21, 2011) (showing that California ranks 14th).

⁸⁰ Assem. 676, 1999 Leg. (Cal. 1999).

⁸¹ Michael Coleman e-mail interview, *supra* note 74.

cities and counties due to their inelasticity. Rates frozen in 1978 often do not come close to accurately reflecting the needs and realities of present-day communities.

Although efforts were made to devise a system that was indexed to cost-drivers, the framers of the allocation system failed to find a system that seamlessly integrated substantial need-based elements. A hearing convened by the Senate Local Government Committee in 1999 on property tax allocation in California stressed the importance of revisiting these outdated formulas. No one spoke in defense of the ancient base shares.⁸² Unfortunately, no one there posited a viable solution that would make the system more responsive to the changing needs of localities throughout California. With the consolidation of control at the state level, the possible generation of input allowing for modifications to the current formula by local stakeholders is effectively precluded.

Our solutions require that policymakers put aside the individual preferences and priorities of the status quo beneficiaries and proceed with a system that reinstates local control and ensures allocation is sensitive to the need for services. Given the realities of the current political, fiscal and legal environments, no single policy alternative is a silver bullet. Therefore, a blend of the policy alternatives is the best option for restoring equity in California's property tax allocation.

The initial step is to create regional property tax boards to reassess the shares of property tax allocated to the local agencies within their jurisdiction. The frozen allocation levels of SB 154 and AB 8 do not adequately reflect the current need for services. Although there are difficulties in assembling a regional board that adequately and appropriately represents the various interests, a board based on electoral districts begins the conversation at the regional level on what service needs and priorities exist within the various local agencies in the county. Despite concerns over the board's representation, various models of representation exist that can be used to provide an appropriate level of responsibility for each of the stakeholders in any particular region in California.

By examining the share of property tax revenue that local agencies receive, we partially address how special districts will go forward after they are no longer direct recipients of the property tax. It behooves the cities and counties responsible for the special districts to ensure that they receive appropriate levels of funding so that critical services remain in place. Various special districts already operate as enterprises, charging user fees to fund their services. However, creativity goes a long way in generating revenue for non-enterprise special districts. For

⁸² S. Local Gov't Comm., Property Tax Allocation: The Summary Report From the Interim Hearing of the Senate Local Government Committee, S. 1999 (Cal. 1999), available at <http://www.sen.ca.gov/locgov/ptasummary.htm>

instance, a traditional non-enterprise service, such as a library, could fund its operations partially by leasing attached office space or classrooms. By removing funding from special districts that can sustain themselves, local agencies would generate greater discretionary funding. They could even appropriate money to special districts that require a greater share. Yet, the appropriate incentives would remain in place to ensure that fees and service charges are not burdensome on residents.

Together, this blend of recommendations will undoubtedly generate additional questions. How, for example, can they be implemented in a way that appropriately takes into account each stakeholder’s current and future needs? If nothing else, though, the measures suggested in this article shift the conversation from the inefficiencies and ineffectiveness of the status quo to constructing a framework for the pursuit of equity in property tax allocation in California.

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Appendix 1

