



The County of El Dorado

330 Fair Lane, Placerville, CA 95667

Staff Report

DATE: July 28, 2009

TO: Board of Supervisors

FROM: Ronald Grassi, Assistant Chief Administrative Officer

SUBJECT: Property Tax Increments

Background:

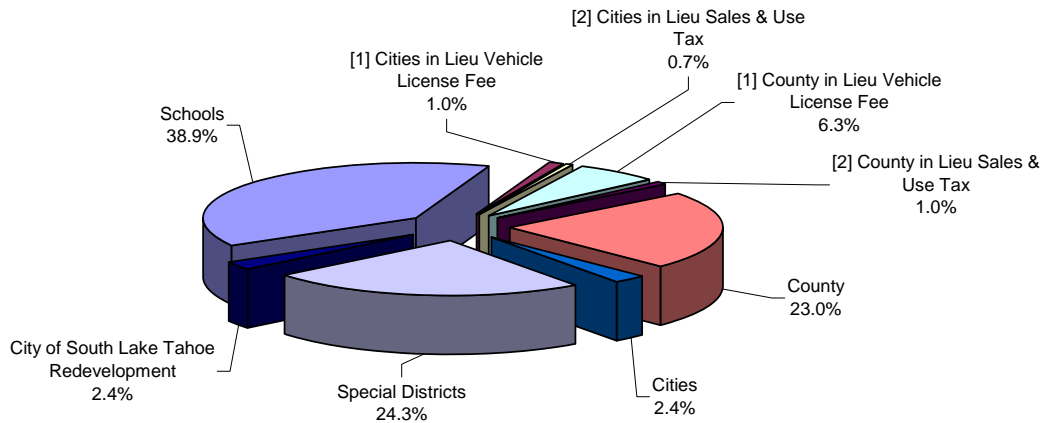
On May 5th 2009 the Board of Supervisors requested a property tax increment workshop for July 27, 2009 following discussion of the Clarksville Annexation to El Dorado Irrigation District (agenda item 09-0545).

Property Tax:

Property Tax is an ad valorem tax that an owner is required to pay on the assess value of the property being taxed. Prior to the passage of Proposition 13 local governments were authorized to set the property tax rates. The total tax rate to any individual parcel was the total of the separate rates levied by each local jurisdiction serving the property such as the County, City, Special District, School District, Community College and Office of Education. After June of 1978 with the passage of Proposition 13 the California ad valorem (based on value) property tax rate was limited by the State Constitution to 1% plus any voter-approved bonded indebtedness, special taxes or benefit assessments. Proposition 13 established an acquisition based assessment system. State and local governments became prohibited from setting tax rates for ad valorem taxes on real property without a two-thirds approval from voters.

The following is a graphic depiction of the distribution of Proposition 13's 1% General Property Taxes within El Dorado County. It is noteworthy that a majority (38%) of the funds are directed towards education. The Special Districts receive 24.3% and the County receives approximately 23%.

**Distribution of Proposition 13's 1% General Property Taxes
Summary of FY 2007/08 Total of \$272,249,141**



Assembly Bill 8 (AB 8)

Immediately following the passage of Proposition 13, a new method was necessary to allocate taxes since taxing jurisdictions now had to share pieces of a finite pie. In 1979, Assembly Bill 8 (AB 8) was adopted to provide procedures for counties to allocate taxes. The base year for AB 8 was the 1978/1979 fiscal year. The basic premise of AB 8 allocates each taxing jurisdiction the amount it received in the prior year, plus a share of any additional revenues above the prior year (increment) that occurred within its boundaries. This established the property tax increment allocation percentage for each agency within a Tax Rate Area (TRA).

Tax Rate Area:

A Tax Rate Area (TRA) is a geographical area composed of a unique combination of taxing jurisdictions that provide services to the property. Due to annexations and detachments a property may move from one TRA to another from year to year. Currently, El Dorado County has over 400 TRAs. TRAs are maintained statewide by the State Board of Equalization in conjunction with information filed by LAFCO, schools, CSAs and other taxing jurisdictions.

Annexations

Annexations are generally governed by §99 and §99.01 of the California Revenue and Taxation Code. The R&T Code contemplates several different types of annexations and other actions triggering an exchange of tax revenue among jurisdictions. Briefly stated these actions include:

1. Non-school jurisdictional changes where services have not previously been provided

Non-school jurisdictional changes where services have not previously been provided are the most common type of annexation in El Dorado County. The use of master tax sharing agreements is allowed for this type of annexation. It is important to note that the exchange of property tax *shall* be limited to the annual tax increment according to R&T Code §99.01(a)(2). Special districts *may* negotiate on their own behalf. However, if they fail to adopt a resolution agreeing to the exchange of tax increment, the Board of Supervisors *shall* determine the exchange of property taxes for that specific special district [§99.01(a)(3-4)].

2. Non-school jurisdictional changes altering existing service areas (where services are already provided)

This is the second most common type of annexation in El Dorado County. The exchange of property tax *may* be limited to the annual tax increment (which is traditionally the case in El Dorado County) [§99(b)(4)]. If the annexation affects one or more special districts, then the Board of Supervisors shall negotiate any exchange of property tax on behalf of the district(s) after consulting the affected districts [§99(b)(5)].

3. School jurisdictional changes altering the existing services areas (where services are already provided)

School jurisdictional changes are addressed through the State Board of Equalization, not LAFCO.

4. Dissolution of a district

Dissolution of a district does not appear to be specifically addressed in the R&T Code, although specific portions of the Code seem to apply.

5. Formation of a district (non-city)

In the formation of a district, it appears that LAFCO makes the determination of the amount of revenues exchanged under Government Code §56810.

6. City incorporation

The County has not realized successful city incorporation since the creation of LAFCO.

7. Renegotiation of previously approved negotiations and/or transfer of revenue between local agencies (no change in services)

8. Consolidation of one or more districts

Consolidation of districts does not appear to be specifically addressed in the R&T Code, although specific portions of the Code seem to apply.

Again, non-school jurisdictional changes where services have not previously been provided are the most common type of annexation in El Dorado County. Typically, a property owner initiates this process so a parcel or group of parcels may be annexed into the El Dorado Irrigation District for water service.

The number of annexations is perhaps driven by the development market. Recently, annexations have been infrequent with only three occurring in the last three years. Although, the number of annexations has been more significant in the past:

- 3 annexations for the 09/10 roll.
- 6 annexations (+ 2 for the schools) for the 08/09 roll.
- 8 annexations (+ 1 for the schools) for the 07/08 roll.
- 7 annexations (+ 1 for the schools) for the 06/07 roll.
- 4 annexations for the 05/06 roll.

From October 2002 through January of 2004 the County was involved 17 annexation projects.

The Annexation Process

In order to begin the annexation process the District, property owner, or registered voter files application for change with the El Dorado Local Agency Formation Commission (LAFCO). LAFCO provides notice of filing to the Assessor and Auditor. Within 30 days of notice of filing, the Assessor provides the Auditor with a report identifying the TRAs and their corresponding assessed values of the territory subject to the jurisdictional change. Within 45 days of notice of filing, the Auditor:

1. Estimates the amount of property tax revenue generated within the area involving the jurisdictional change by multiplying the assessed value by one percent.
2. The Auditor also estimates what portion of the property tax revenue is attributable to each affected local agency from the subject territory (multiplying the amount from step number 1 by the TRA tax increment allocation percentage of each jurisdiction). For those counties with ERAF at a jurisdictional level, the net amount of property tax revenue may need to be adjusted for ERAF.
3. Provide the above data to LAFCO the affected agencies, and the Chief Administrative Office on behalf of the County.

Agencies have 60 days from the date of receipt of notice from the Auditor to negotiate a tax exchange. The negotiated agreements must be adopted by resolution by each affected agency.

The County, EID, El Dorado Hills CSD, Cameron Park CSD and many of the west slope fire protection districts have a “gentlemen’s agreement” with regard to the minimum percentage of tax increment that each agency will accept as a condition of annexation. Although the Chief

Administrative Office has found no evidence that this agreement was ever formalized, there appears to be consensus that the traditional minimum percentages are acceptable.

Following notification from the Auditor's Office of the amount of property tax revenue generated within the area involving the jurisdiction change, the Chief Administrative Office builds a negotiation schedule allowing adequate time for affected agencies (including the Board of Supervisors) to adopt tax exchange resolutions. As an example, recent annexations in El Dorado County have involved the annexation of property into the El Dorado Irrigation District so it can provide water service. A practical consequence of this is that EID expects 2.6667% of the tax share as a result of annexation. To come up with EID's new share (+2.6667), the Chief Administrative Office proposes a proportional reduction in the existing shares of the tax levy among all other affected agencies to generate a possible exchange of tax increment. If the proportional reduction results in a percentage lower than the agreed minimums, the Chief Administrative Office makes proposed adjustments to the shares of other affected agencies who are receiving more than their specified minimum.

Once the calculation is complete a letter is sent to EID specifying the suggested exchange of tax increment, and requesting written notification of agreement. Letters are also sent to affected agencies with the suggested exchange in tax increment. Letters to affected agencies request a response within 14 days if the agency disagrees with the suggested changes in tax increment.

Following the close of the 14 day period, the Chief Administrative Office prepares a Board agenda item and a Resolution agreeing to the exchange of tax increment. Following Board approval of the Resolution, the Board Clerk provides a copy to LAFCO and affected agencies.

At the conclusion of the annexation process LAFCO notifies the Auditor of the completion and of all the jurisdictional changes, and files documents with the State Board of Equalization. If the affected agencies fail to adopt a negotiated agreement, LAFCO will refer to the appropriate guidelines provided in the Revenue and Taxation Code §99.

Master Agreements

Under R&T Code §99(d), counties, cities and special districts may negotiate standing master tax sharing agreements in order to gain consistency and speed the process of the negotiations step on the exchange of base revenue; others may negotiate only on future increment by restricting the negotiations to the TRA allocation factors used to distribute the future growth. In certain cases the law requires that future exchange of tax increment be the only item negotiated. To establish master tax sharing agreements the County and all the special districts would have to formally agree on specified tax rates. With over 400 tax rate areas and dozens of local agencies, developing a master tax sharing agreement would require a significant commitment of resources. In addition, given the infrequent nature of annexations coupled with the success of recent annexation-driven negotiations, the benefit of a master tax sharing plan does not seem to outweigh the burden of developing an agreement.

The property tax increment is a zero sum game in order for an increase to occur in one jurisdiction a reduction must take place in another. In a downturned economy, local agencies

may be reluctant to give up a small percentage even if it means a general increase in revenue. However, the Board of Supervisors under Revenue and Taxation Code §99.01(a)(4) authority to resolve tax revenue disputes within its boundaries.

Ultimately, local agencies have an incentive to complete the negotiation process even if minor disagreements persist regarding exchange of tax increments. Using the recent Clarksville Annexation to EID as an example, property tax payable to local agencies (excluding schools) for two undeveloped parcels totaled \$17,086. Property tax payable as a result of development of these parcels totaled \$78,653.¹

Propositions 90, 110 and 60

Propositions 90, 110 and 60 all provide some form of relief to homeowners from the acquisition driven assessment process established through Proposition 13. Sometimes, referred to as the “empty nester provisions,” the idea behind these propositions is to free up larger houses for families, and preserve affordable property tax payments for those on fixed incomes.

Proposition 90, passed in 1988, allows qualifying property owners to transfer their low assessments from one county into another on the basis of age, (55 years or older). Similarly, Proposition 110, passed in 1992, allows the same benefit on the basis of disability. Both Proposition 90 and 110 are “local option” laws, allowing the county board of supervisors to participate through the adoption of an implementing ordinance.

Proposition 60, passed in 1986, requires Assessors to transfer low assessments from one property to another within the same county provided all qualifications are met including the application and claim. Proposition 60 is state law and is not optional for counties. Currently, 716 applications have been approved and 318 denied in El Dorado County since Proposition 60’s inception.

Basic Qualifications for Propositions 90, 110 and 60

The basic qualifications for the three Propositions include but are not limited to the following:

1. The original property was eligible for the Homeowner’s Exemption as the principal place of residence when sold.
2. As of the date of sale of the original residence, the claimant is a least 55 years of age or disabled.
3. The replacement residence is purchased or newly constructed within two years of the sale of the original property.
4. The replacement dwelling value is equal to or less than the value of the original property.
5. The claimant has not been previously granted this property tax relief, except in the case of subsequent disability.
6. The claim is filed within three years of the date the replacement is purchased or newly constructed, or only prospective benefit.

¹ Based on assessed value of \$150 sq/ft. See Clarksville Annexation to EID “Financial Analysis”, File ID 09-045, Board of Supervisors, May 5, 2009.

Although the basic qualifications appear fairly simple, there are many scenarios which can result in disqualification. Some are complex.

At one time there were 13 counties which had adopted ordinances. That number has dwindled to 7, none of which are 'foothill' rural type counties: Alameda, Los Angeles, Orange, Santa Clara, San Mateo, San Diego and Ventura. While Modoc County accepted out-of-county low assessments over 15 years, it conducted annual surveys of residents' motivations for moving there. Only three indicated they moved to Modoc County because of a Proposition 90 benefit incentive. Respondents in the Modoc surveys said they were against growth, business and development and wanted to move away from urban neighborhoods. They do not want to change the rural environment. The case may be different for El Dorado County, but people move here for other reasons despite the non-existence of Proposition 90.

Most Proposition 90 applicants are retirees from urban counties. Market prices vary from county to county but homes are generally more expensive in the Bay Area, Los Angeles, et cetera than in El Dorado County. Retirees can therefore purchase larger, better quality homes and still meet the requirement of replacement market value equal to or less than market value of the original. This could be a factor causing increased sales activity. A typical scenario would be the following example where FBYV stands for Factored Base Year Value (the low assessment):

Sale in Bay Area	Purchase in EDC	FBYV transfer	Revenue Loss
\$1,200,000	\$1,200,000	\$300,000	\$9,000 per year

Last year in El Dorado County there were roughly 5,000 sales. It is unknown what portion of the sales and newly built houses were the result of migration, a tracking history would be required to develop statistics on low assessments being transferred into the County. As an example, if 10% of last year's buyers (500/5000) were able to transfer their low property tax assessments into the County, resulting in a revenue loss of \$9,000 each, the total revenue loss to the County would be \$4.5 million per year.

Proposition 90 does enhance the purchasing power of a select category of people since the property tax costs of home ownership are less. By transferring reduced assessments, potential Proposition 90 claimants having an edge on the competition who will ultimately pay more for the same residence. Therefore, Proposition 90 may help re-establish market levels.

There may also be an effect on lending institutions. People age 55 or older generally have large equities, borrow less frequently and borrow less money than younger growing families; but loans would be well secured.

The interests of retirees may conflict with younger families in some cases. Younger families are the work force population which may be more interested in local jobs and businesses nearer homes. Retirees are often interested in travel and keeping their surroundings rural. Would Proposition 90 promote more of a bedroom community?

Would there be an effect on local sales tax? Retirees and growing families are different types of consumers. Retirees are often on a fixed income. Which group would shop outside of county more? The types of purchases differ and families are perhaps larger consumers.

One would certainly think that the attraction of Proposition 90 might stimulate demand for new construction and the inventory of existing products would diminish to sales. New products currently for sale would have more demand. Proposition 90 would probably benefit developers, builders, and increase the number of sales commissions for the real estate industry. But it is difficult to forecast without statistical data to quantify.

As for school districts, revenue is based on pupil enrollment formulas. Would the increased residency of age 55 people or retirees versus families with school children have an effect on school revenue? Some have speculated that the influx of retirees or senior improves the number of good citizens and therefore lowers the crime rate.

However, the main concern with Proposition 90 is the property tax revenue loss, due to lower assessments. Currently, the assessor is estimating more than a 1% decrease in the property tax revenue for FY 2009/2010. The implementation of Proposition 90 would place additional burden on property tax revenue. This will affect not just the County general fund but also, the Community Services Areas, and Fire Districts a reduction in property tax converts directly to a loss of revenue.

In January 1989 Proposition 90 was discussed at the Board of Supervisors and a policy was established to reject Proposition 90 in El Dorado County. The CAO recommendation is to sustain the County's current position.

Request Board Direction:

- 1) Should the County pursue a master tax agreement with El Dorado Irrigation District, the Community Service Districts, the Fire Districts and all other entities involved, or continue to handle annexations on a case by case basis?
- 2) Should the County implement an Ordinance to adopt Proposition 90?