



# Napa County

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## Legislation Text

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**TO:** Board of Supervisors  
**FROM:** Minh Tran, County Executive Officer  
**REPORT BY:** Nelson Cortez, Staff Assistant - BOS  
**SUBJECT:** Vehicle License Fee Update

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### **RECOMMENDATION**

County Executive Officer, on behalf of the Legislative Subcommittee, requests discussion and direction on a State legislative budget issue related to Excess Educational Revenue Augmentation Fund (ERAF) and Vehicle License Fee. UNANIMOUS VOTE REQUIRED.

### **EXECUTIVE SUMMARY**

The County of Napa has been working with State Representatives to address an imminent budget issue that, if not resolved at the State level, would result in an annual loss of revenue of close to \$40M to Napa County and its cities/town collectively. The State has put forward a proposal to address the issue. The purpose of this item is to provide an overview of the issue and receive direction and/or action from the Board for moving forward. On May 9, 2022, the Legislative Subcommittee discussed the matter and directed staff to bring this issue to the Board of Supervisors without a recommendation.

### **FISCAL & STRATEGIC PLAN IMPACT**

Is there a Fiscal Impact?	Yes
Is it currently budgeted?	No
Where is it budgeted?	N/A
Is it Mandatory or Discretionary?	Choose an item.
Discretionary Justification:	Click or tap here to enter text.
Is the general fund affected?	Yes
Future fiscal impact:	Potential loss of \$23M+ annually in General Fund if no fix is made at the State level
Consequences if not approved:	Click or tap here to enter text.
County Strategic Plan pillar addressed:	Effective and Open Government
Additional Information	Click or tap here to enter text.

## **ENVIRONMENTAL IMPACT**

ENVIRONMENTAL DETERMINATION: The proposed action is not a project as defined by 14 California Code of Regulations 15378 (State CEQA Guidelines) and therefore CEQA is not applicable.

## **BACKGROUND AND DISCUSSION**

Due to state budget issues, shifts, and different state priorities that go back decades, Napa County and its cities and town have been placed in a position that will result in using local property tax dollars to pay for State obligations if a recently proposed legislative change is adopted as a budget trailer bill. Currently, all K-14 schools in Napa County are fully funded to their Local Control Funding Formula guarantee using local property tax dollars. This proposed change does not affect or harm school funding in any way. The proposal impacts future funding to the County, Cities, Town, and Special Districts.

This agenda item has been prepared by Staff without the benefit of reviewing the State's latest proposal. The Department of Finance has not allowed Counties to view the text of the proposal before the Governor's May Revise is released.

## **HISTORICAL CONTEXT**

Historically, the Vehicle License Fee (VLF) rate, beginning in 1948, was 2 percent of the value of vehicles, which would go directly to local governments. Beginning in 1998, the state reduced the VLF rate and agreed to offset the loss of local revenues to the cities/towns and counties with General Fund payments.

During Governor Gray Davis's administration in 2003, the State experienced major budget shortfalls, operating on borrowed cash, and could no longer afford to make the backfill payments out of the state General Fund. The state restored the vehicle license fee to its previous level, tripling the amount, beginning October 2003. This allowed the State to avoid shifting funds to backfill local governments for lost VLF funding. After the recall of Governor Gray Davis, newly elected Governor Arnold Schwarzenegger rolled back the vehicle license fee and reinstituted the direct backfill of lost funding to local governments.

As part of the 2004 budget agreement, the Legislature enacted a "VLF-property tax swap," which permanently reduced the VLF rate to 0.65 percent, repealed the direct offset payments from the state General Fund, and instead replaced lost local revenues with property taxes that would otherwise have gone to schools through the Educational Revenue Augmentation Fund (ERAF) in each county. This agreement tied the growth calculation of the VLF to property tax instead of vehicle registration. The replacement funding is known as the "VLF adjustment amount." The VLF Swap was developed through negotiations with local governments which included local governments agreeing to shift an additional \$1.3 billion of local property tax funds into ERAF (ERAF III) to help the State manage their 2004 budget shortfall.

**CURRENT LAW**

Revenue and Taxation Code 97.70:

- County auditor-controller shall take funds from ERAF to fund VLF Adjustment. The State then backfills local school agencies by an increased General Apportionment. RT 97.70(a)(1)(A)
- If there is not enough funds in ERAF to fully fund the VLF Adjustment, county auditor-controllers shall reduce the amount of property tax allocated to non-basic aid school districts to fully fund the VLF Adjustment. RT 97.70(a)(1)(b)
- RT 97.70 does not address the funding mechanism when there is insufficient funds allocated to both ERAF and non-basic aid school districts to fully fund the VLF Adjustment. Past practice is a county calculates the deficiency at the end of the fiscal year of the shortfall (year 1), submits a claim to the DOF in the year following the shortfall (year 2), which is included in the subsequent fiscal year's budget (year 3).
- RT 97.70(f)(1) provides a hold-harmless guarantee that the VLF statute will not reduce excess ERAF allocations to cities, counties or cities and counties.

**NAPA COUNTY ISSUE**

When the VLF Swap was created during the state's financial crisis of 2004, an important provision to hold-harmless local agencies was negotiated by the Department of Finance (DOF) to create a mechanism for local agencies to assist the State in covering its budget shortfall by utilizing non-basic aid districts to fund the VLF Swap. What was not contemplated, however, in any budget analysis, was what consequences would bear if all districts became basic aid, and the potential impact it would have on counties. Since that time, five of the county's six K-14 school districts have become basic aid, and once the remaining district, the Napa Valley Unified School District, becomes fully basic aid, the County and its cities/town will be in an untenable circumstance. The county auditor-controller will have no available tax allocations to shift to fill the VLF Adjustment for the County, cities or town resulting in a two-year delay of discretionary funding totaling approximately \$40M annually to local jurisdictions.

2021-22 VLF Swap

County of Napa	\$23,884,394
City of American Canyon	\$ 1,852,162
City of Calistoga	\$ 863,720
City of Napa	\$ 9,934,234
City of St. Helena	\$ 834,898
Town of Yountville	\$ 770,000
Total 2021-22 VLF Swap	\$38,139,408

### **NAPA COUNTY PROPOSED FIX**

Foreseeing the aforementioned issue, Napa County proposed a statutory fix in 2021 that would establish a mechanism for the County to alert the DOF of the anticipated shortfall. This would give the DOF time to build coverage of the shortfall into the next State budget, so that there would be no disruption to services or necessary reductions in staffing or services at the County or its cities and town. Staff, led by the Auditor-Controller and Treasurer-Tax Collector, met with County representatives, state officials, including the Department of Finance, Legislative Budget Staff, the Legislative Analyst Office (LAO), and the Governor's Office to ensure all bases were covered before the 2022 Governor's Budget was announced.

It should be noted that the State already budgets for VLF through its funding to the schools since the mechanism for VLF is payment through ERAF. The fix does not impact the State's budget, it only requires the shift from one line item to another, while keeping schools, counties, cities/towns and special districts whole.

### **STATE PROPOSAL**

In the Governor's January release, the DOF's draft included a change to RT 97.70(f)(1) eliminating the hold-harmless provisions as they relate to counties and cities. The revised bill would require counties to first use excess ERAF to fund the State's VLF Swap obligation when in an insufficient ERAF position. The County opposed this change since it would result in a permanent loss of over \$30M per year throughout the county and result in no new funding for local schools.

During a meeting on May 4, 2022, the Governor's Office and the Department of Finance informed the County's delegation significant changes had been made to their proposed legislative change. It is Staff's understanding, draft language has not been made available, the new proposal will require counties to use *growth* in excess ERAF as the first funding source for the State's VLF Swap obligation when a county is in an insufficient ERAF position with the State backfilling the remaining shortfall.

### **IMPACT OF CURRENT STATE PROPOSAL**

The revised bill, as explained by the DOF and Governor's Office, would allow the County, cities/town and special districts to receive excess ERAF, but the amount of excess ERAF would be capped at the 2021-22 amount, but only when in an insufficient ERAF position.

In the years leading up to NVUSD's migration to basic aid status, the County, cities/town and special districts will continue to receive the full calculated excess ERAF and the County, cities and town will continue to receive the State's full VLF Swap obligation.

The risk of not accepting this proposal could ultimately mean the Department of Finance determines the State does not have to fulfill the VLF Swap obligation outside the current mechanism to fund it through a direct appropriation with a two-year lag. There is nothing in current law that requires the State to fund VLF.

#### ***Pros***

---The County, Cities, Town, and Special Districts will maintain a significant portion of excess ERAF which would have been eliminated in the initial proposal.

---Creates a continuous appropriation for remainder of VLF Shortfall (until the resulting revenues above the cap exceed the VLF amount) and includes the mechanics proposed in the County's initial legislative fix.

### ***Cons***

- Caps excess ERAF at 2021-2022 levels during a period of increased AV and declining enrollment.
- County, Cities and Town would be funding a portion, or potentially all, of the State's VLF Swap obligation.
- Would result in Napa County taxpayer dollars funding other State obligations.
  - Unless addressed, Special Districts that contribute to ERAF would be harmed by the loss of growth in assessed value as they do not receive the benefit of VLF funding.
- Unless addressed, there is no provision once the growth exceeds our VLF payback for those funds to be redistributed to the ERAF contributing entities.
- Affects other counties in the State, compounding the issue of local property taxes being used for State obligations.
- Opens the door to allow future State raids on local property taxes and ERAF.

### **IMPACTS ON SCHOOL FUNDING**

This bill has no impact on School Funding:

- The bill has no impact on the Prop 98 Guarantee in a Test 1 year.
- Education funding is specifically held harmless from the impacts of the VLF Swap.
- All public schools in Napa County are currently funded to their Local Control Funding Formula Limit using local property tax dollars.
- NVUSD, the county's only non-basic aid school district, is currently only backfilled by the State for property tax dollars shifted from the District to fund the State's VLF Swap Obligation. Once basic-aid status, NVUSD will no longer be impacted by ERAF or VLF, and will continue to be fully funded through local property tax dollars.

### **OPTIONS FOR BOARD ACTION**

According to our State lobbyists, the current proposal from the State is the "best" we will receive from the State with this budget proposal. The Board has the following options:

#### ***Support State Proposal:***

Supporting the proposal would show we agree with the compromise and forgo future growth in Excess ERAF. If in the future Napa County would like to pursue the original fix, the State could ignore based on the County's support to the compromise.

#### ***Oppose State Proposal:***

Opposing the proposal would require working with our State legislative representatives to advocate for Napa County's proposed fix instead. The Board may oppose the State proposal and either counter with an amendment for the original fix that limits it to counties with a General Fund of less than \$400M to address Napa County issues or try again next year.

