

# Overview of the Vehicle License Fee Shortfall in San Mateo County

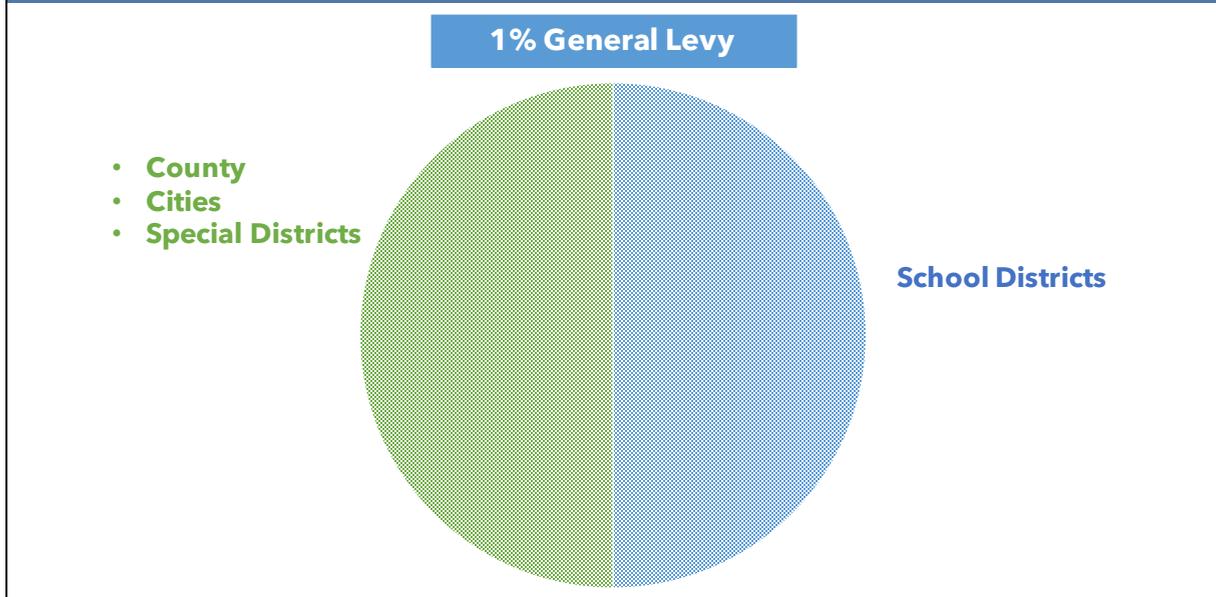
**COUNTY OF SAN MATEO**



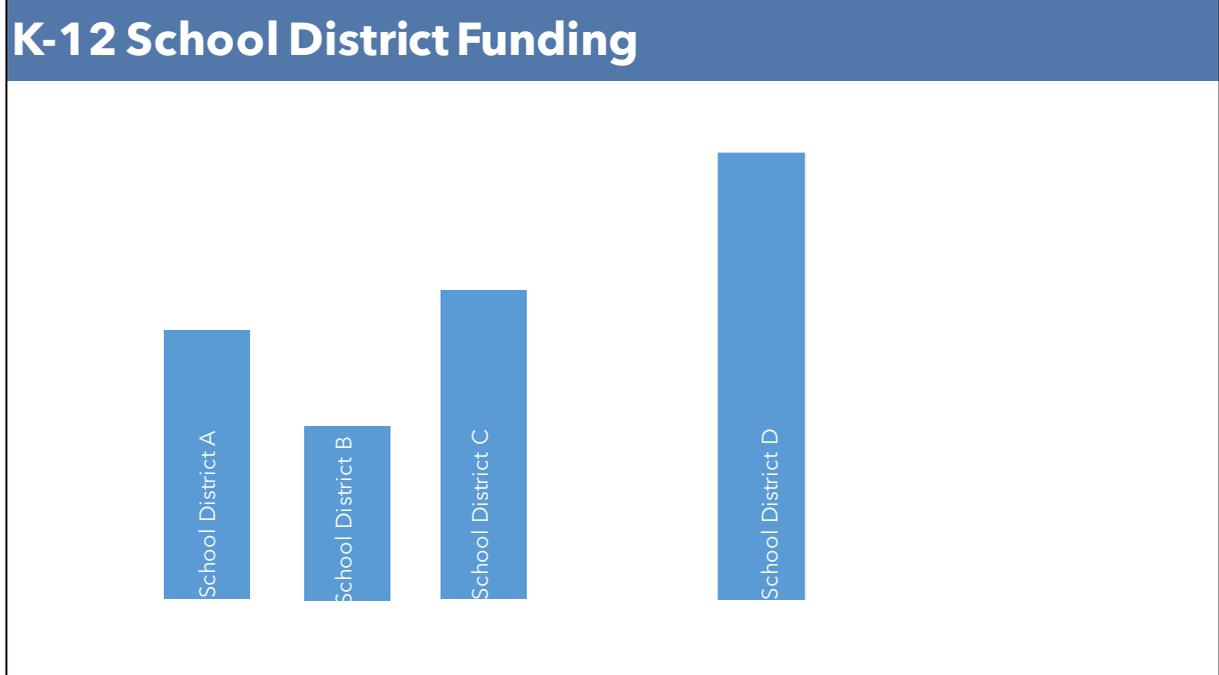
**IMPORTANT NOTE:** This slide presentation was prepared by the County Executive's Office with input from the County Attorney's Office. The purpose of this slide presentation is to provide a conceptual overview of the VLF shortfall in San Mateo County. Local school funding, Prop. 98, the administration of the local property tax system, and the calculation and funding of VLF are all complex processes based on detailed legal and fiscal frameworks, a comprehensive description and explanation of which are beyond the scope of this slide presentation. All examples and figures have been simplified for explanatory purposes. Specific data on the distribution of local property taxes among taxing jurisdictions in San Mateo County can be reviewed in the annual Property Tax Highlights for San Mateo County, published by the San Mateo County Controller's Office and available at <https://www.smcgov.org/controller/property-tax-highlights>.

The explanatory text contained in this presentation describe the specific graphics and examples depicted in these slides. The text and notes of the slides are not intended as independent explanations of concepts separate from the the specific graphics and slides to which they are attached and should not be cited or quoted as such.

## Local Property Tax Apportionment

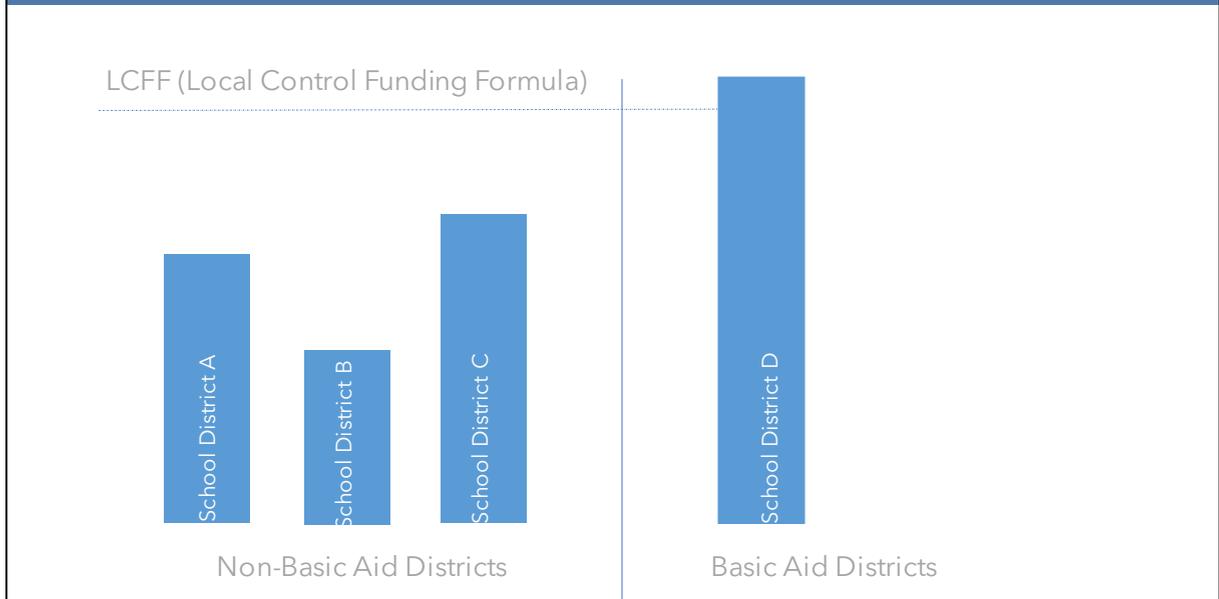


- Under Prop. 13 and its implementing legislation, the 1% general tax levy is divided among all local taxing jurisdictions.
- On a countywide basis in San Mateo County, local school districts in FY22-23 were apportioned approximately 52% of the general levy, with the rest divided among the cities, special districts, County, and RDA successor agencies. To simplify the discussion, this graphic shows a 50/50 split between school districts, on one hand, and cities, special districts, and the County, on the other.



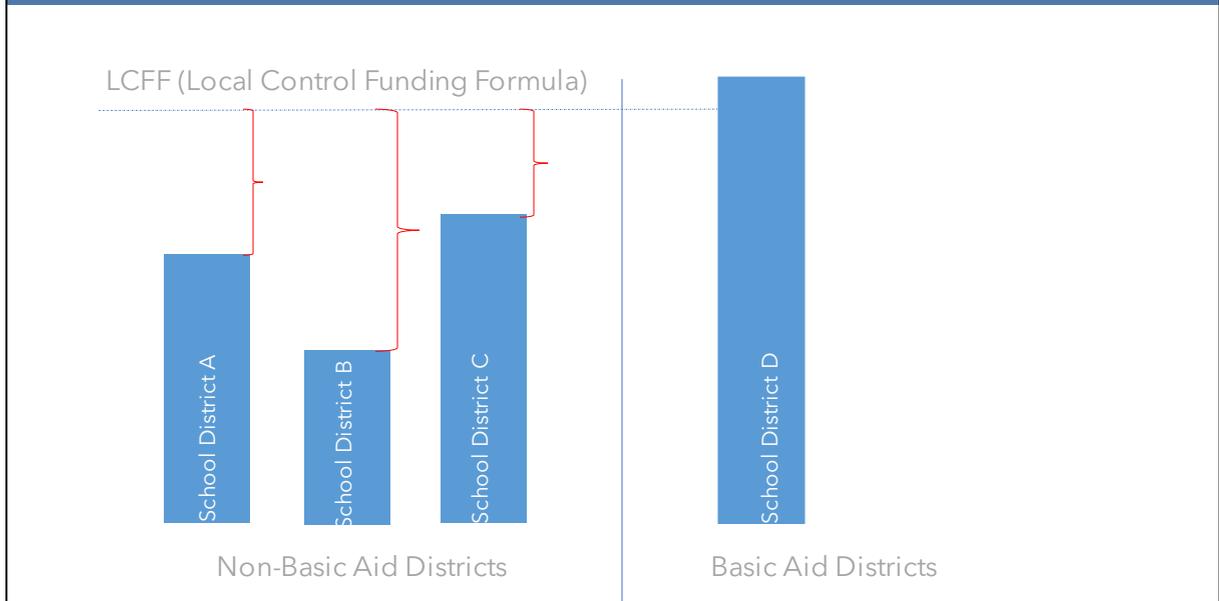
- Because the funding mechanism of VLF is intertwined with the manner of local school district funding, it's important to start with an overview of how local K-12 school districts get funded. [Note: community college districts and county offices of education are subject to a similar funding framework, but the focus of this presentation is on K-12 schools].
- Historically, school district funding was driven primarily by the amount of local property taxes apportioned to each local district, as represented by the blue bars of varying heights on this slide.

## K-12 School District Funding



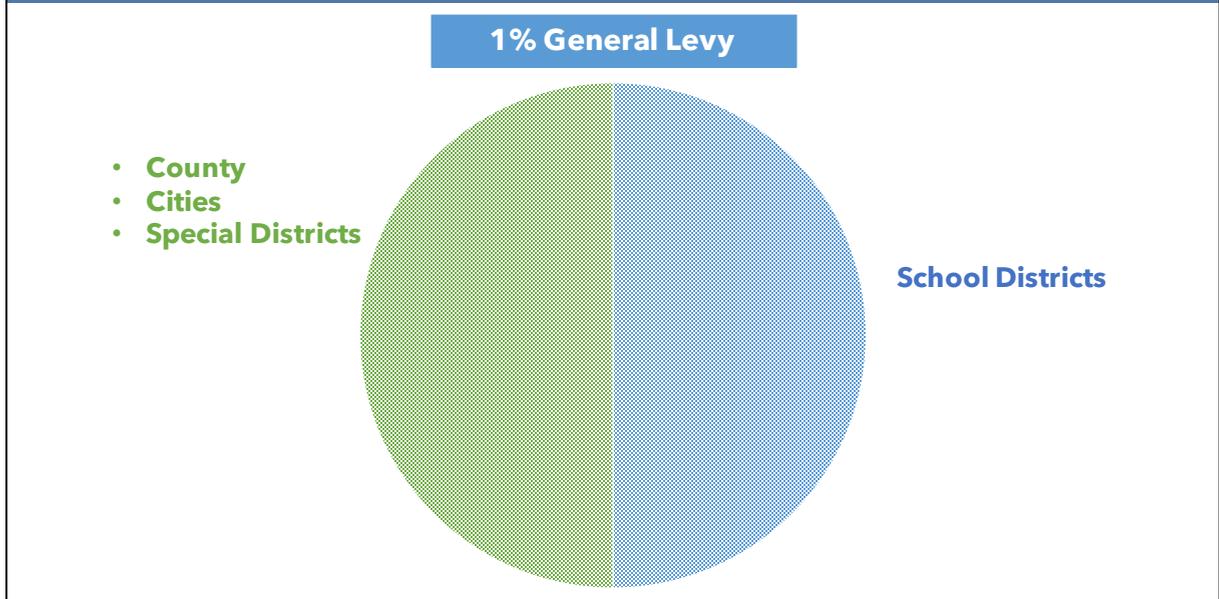
- In 1988, Prop. 98 obligated the State to guarantee that every district receives a minimum amount of per-student funding. This minimum funding guarantee was previously known as the “revenue limit” but is now known as the Local Control Funding Formula or LCFF.
- When a local school district’s local property tax revenues are equal to or exceed the LCFF (represented by School District D in this graphic), it is known as a Basic Aid school district. The State has no obligation to provide additional funding to this school district to meet its minimum funding guarantee other than the constitutionally required minimum funding, or “basic aid,” which is approximately \$120/student.

## K-12 School District Funding



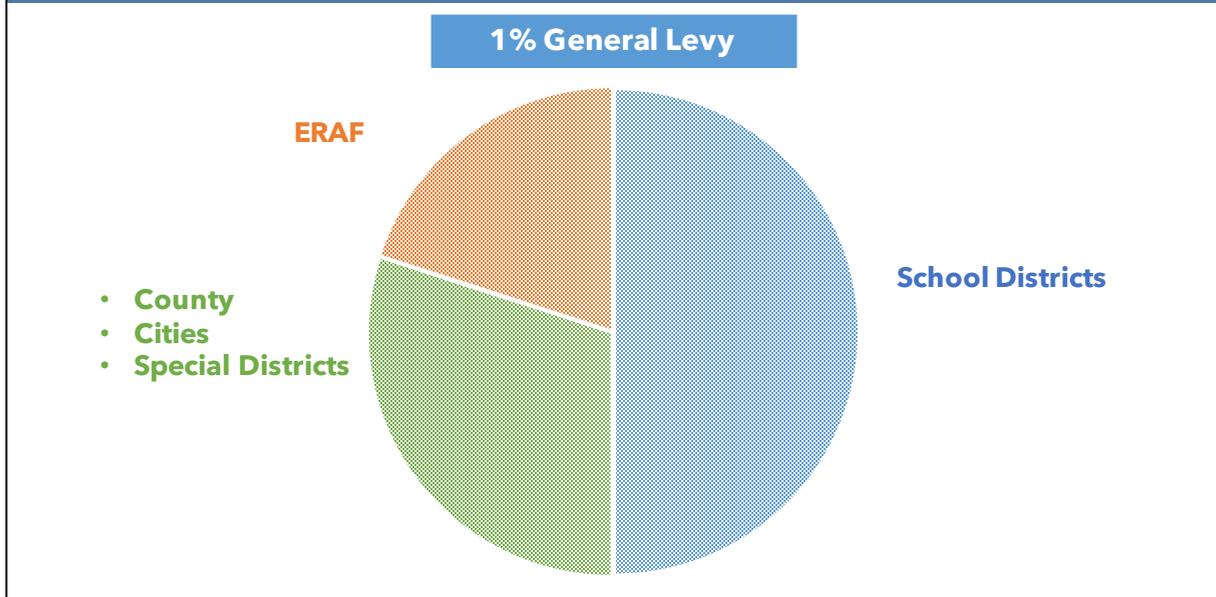
- School districts that do not receive sufficient local property tax revenue to meet the LCFF (represented by school districts A, B, and C in this graphic) are known as Non-Basic-Aid Districts (non-BA districts). For these districts, the State is obligated under Prop. 98 to provide the additional funding needed by each district to fill the gap (represented by the red bracket in this graphic) between the minimum funding guarantee, or LCFF, and the amount of local property tax revenue received by each district.

## ERAF (Education Revenue Augmentation Fund)



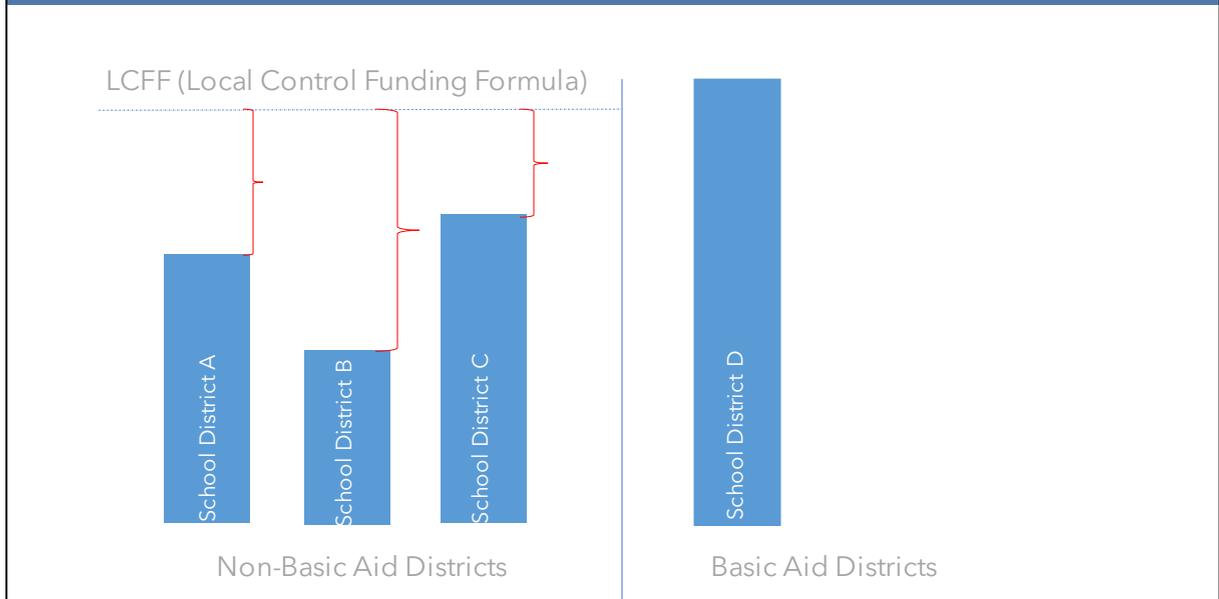
- As part of efforts to address the State's budget crisis in the early 1990s, the State created the Educational Revenue Augmentation Fund, or ERAF, as an additional source of local funding for school districts to help meet the State's minimum funding obligation.
- To understand how this funding mechanism works, we return to the graphic of the allocation of the 1% general tax levy among local jurisdictions.

## ERAF (Education Revenue Augmentation Fund)



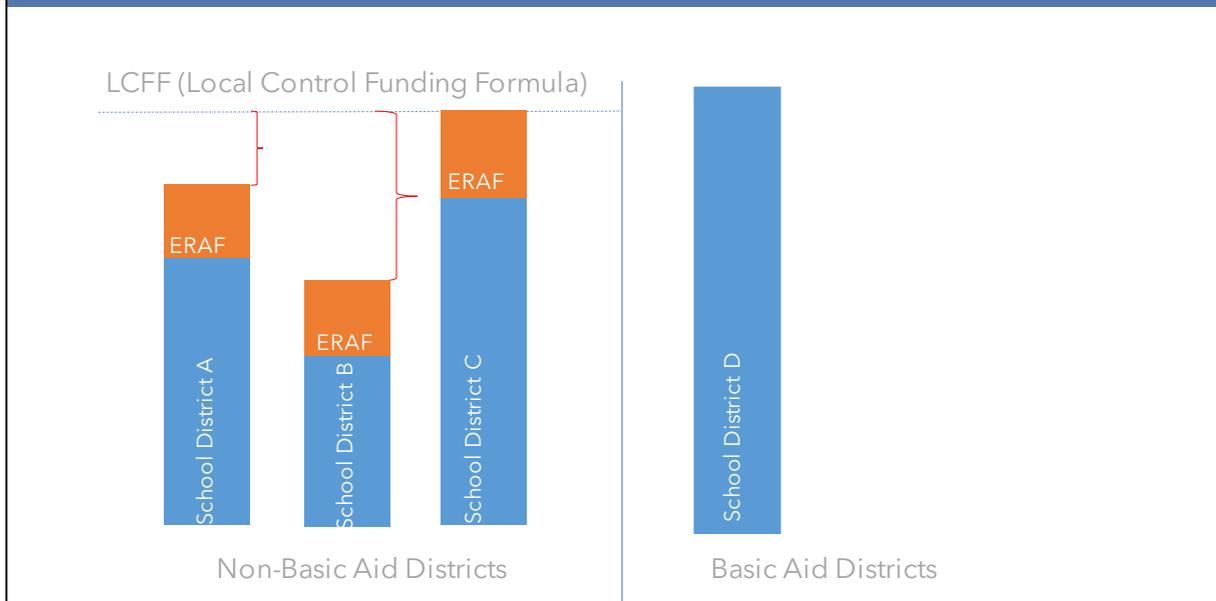
- The ERAF framework involves a complex set of calculations and processes, but at a conceptual level, it shifts of a certain amount of local property taxes from the cities, County, and special districts, and makes those funds available to satisfy the State's Prop. 98 guarantee to fund non-BA districts up to their LCFF.

## K-12 School District Funding - ERAF

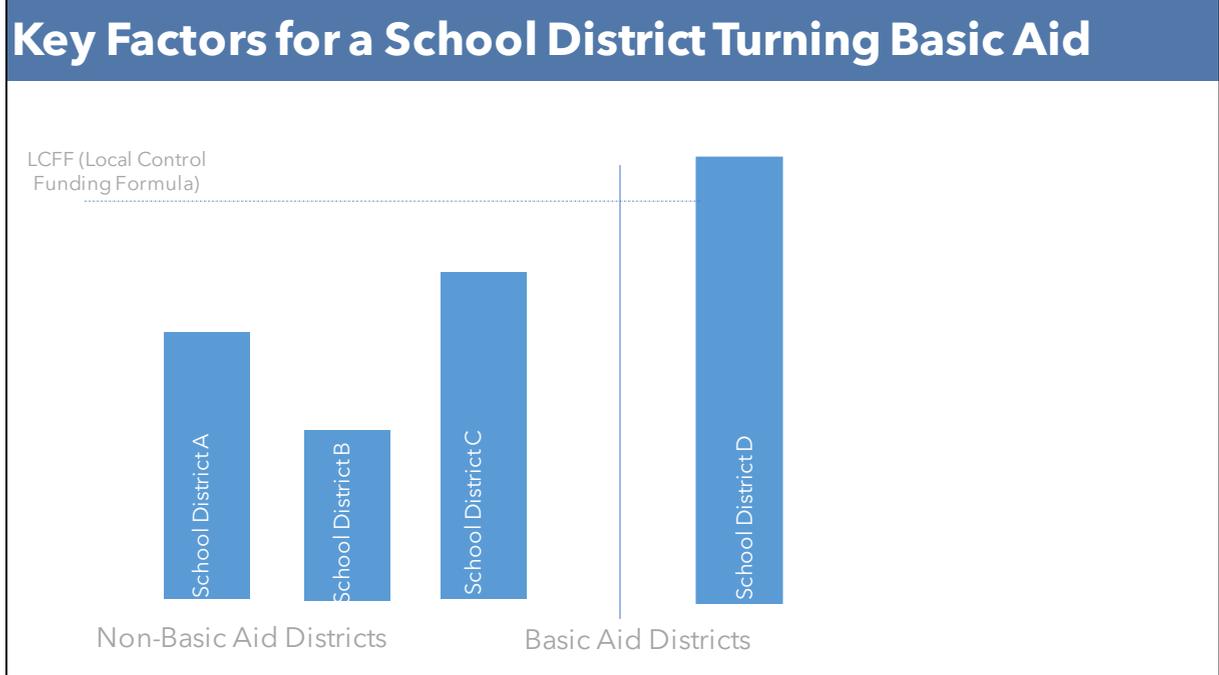


- Let's return to the graphic depicting school district funding prior to the creation of ERAF to show the impact of ERAF.
- The State's obligation to fill the gap between each non-BA district's local property tax revenue and the minimum funding guarantee is represented by the red brackets.

## K-12 School District Funding - ERAF

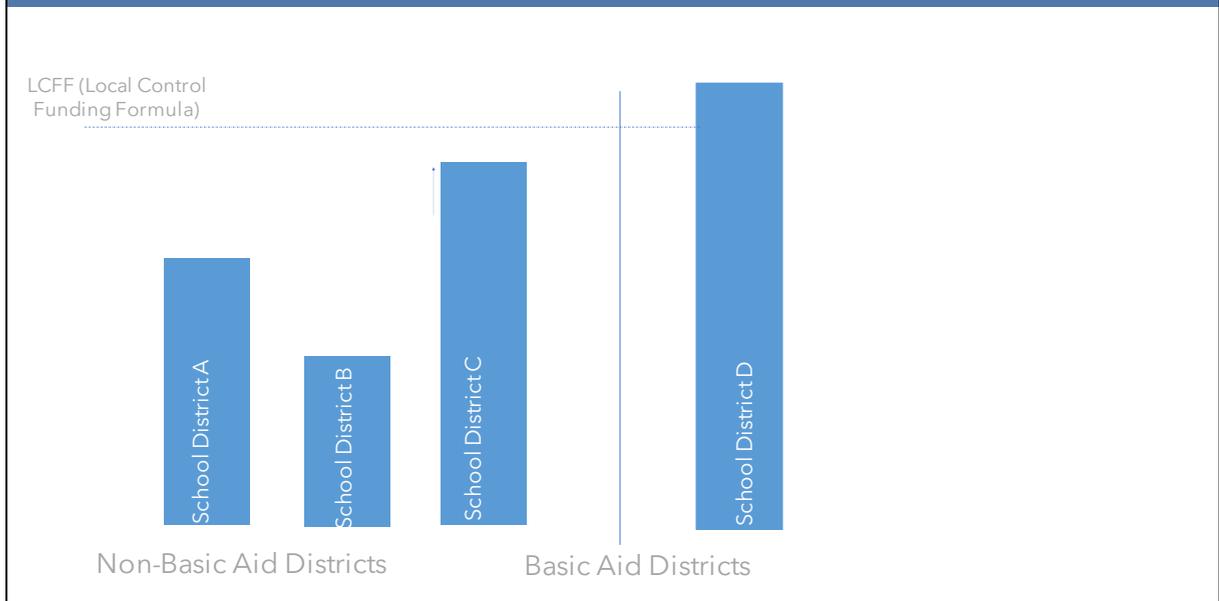


- Under the ERAF framework, each non-BA school district now receives an ERAF entitlement, represented by the orange block.
- The State is still obligated under Prop. 98 to provide any additional funding needed for each non-BA district to meet the LCFF, but because of the ERAF allocation to non-BA school districts, the gap that the State must fill is now reduced (represented by School Districts A & B in this example) or even eliminated (School District C).
- While this graphic represents only a theoretical example of a mix of four school districts in a county, it approximates the funding landscape in the vast majority (~52) of counties in the State: while there may be some basic aid districts, most districts are non-BA, and even after ERAF is distributed to non-BA districts, the State must still provide additional funding to non-BA districts to fill them up to their LCFF.
- In San Mateo County, the ERAF entitlement is sufficient to fill each non-BA district to its LCFF. In other words, all school districts in San Mateo County as of 2023-24 fall into the situation generally represented by either School District C or D in this graphic.



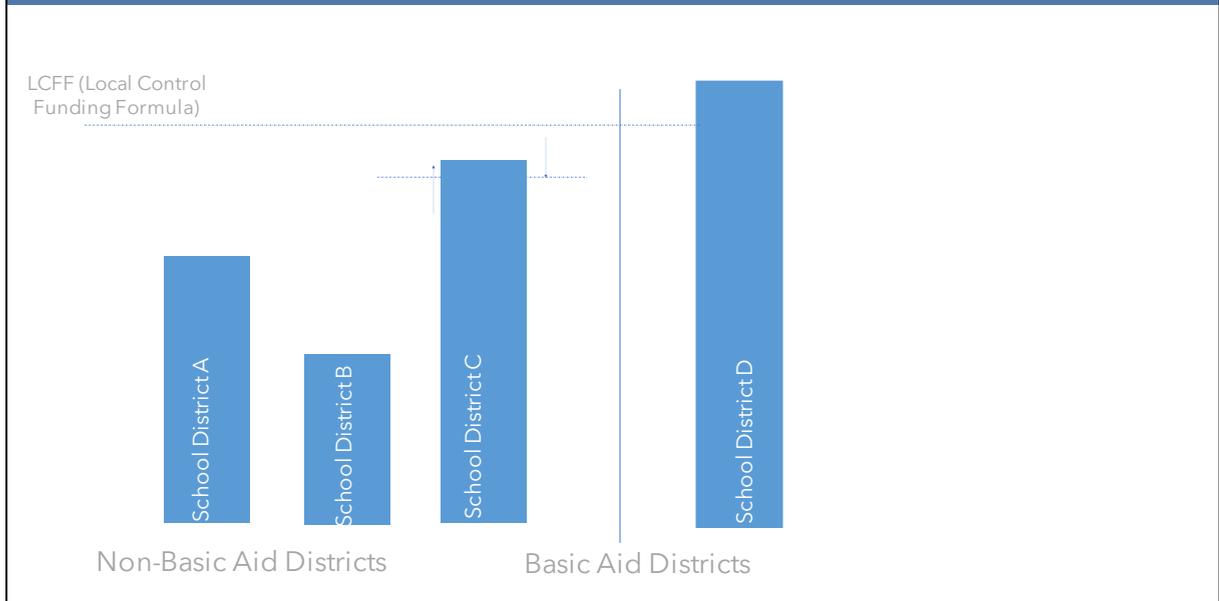
- Let's return to the basic K-12 school funding model. The school district funding environment is dynamic, and multiple factors may cause the gap between the amount of local property taxes received by a non-BA school district and the LCFF to shrink or even be eliminated, causing a non-BA district to "turn basic aid" (the reverse also occurs but is not the primary focus of this presentation).
- There are two key factors that contribute to a district turning basic aid.

## Key Factors for a School District Turning Basic Aid



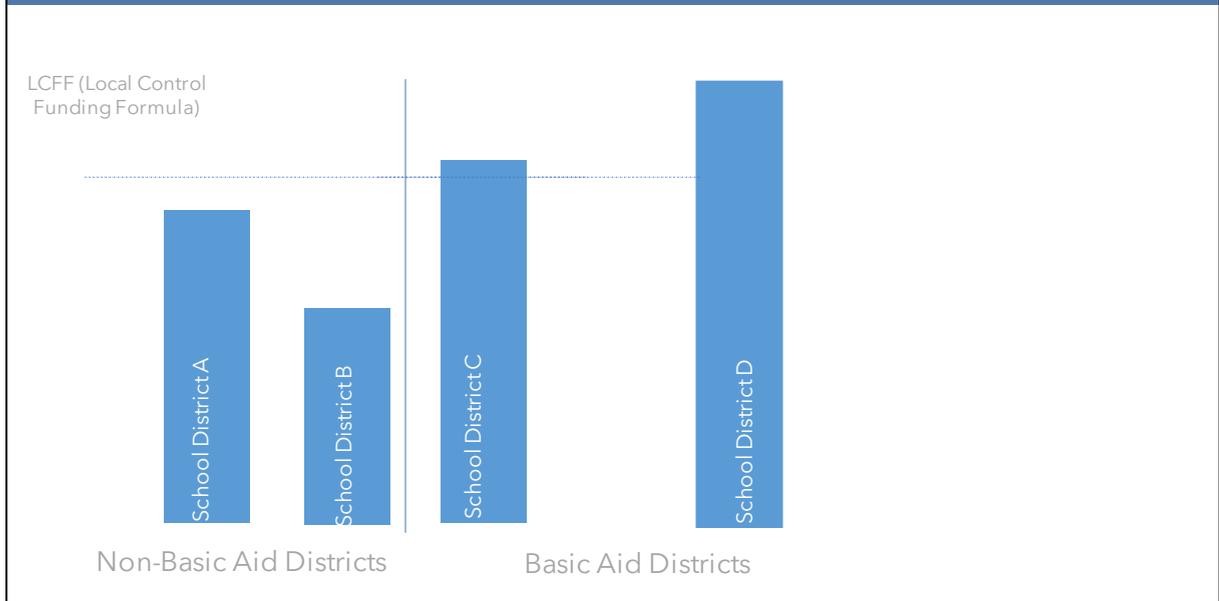
- First, a school district's local property tax revenues might grow relatively faster than the LCFF. This is depicted in this graphic by a relatively higher blue bar for School District C.

## Key Factors for a School District Turning Basic Aid



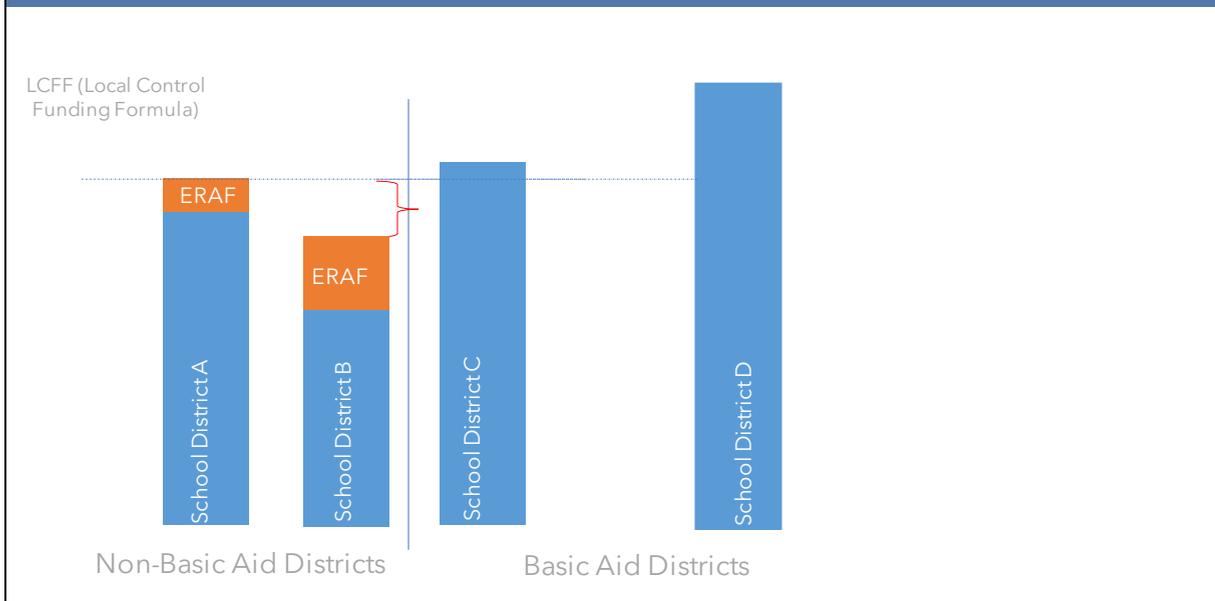
- Second, the minimum funding guarantee (calculated on a per-student basis) for a school district could become relatively lower, for example, due to lower enrollment caused by local demographic changes or disenrollment from the public school district. This would have the effect, as depicted here, of a lower LCFF for School District C.

## Key Factors for a School District Turning Basic Aid



- What is the result when these sorts of dynamics play out across all non-BA districts?
  - School District C now receives sufficient local property tax revenues to exceed the LCFF. It has now “turned basic aid,” and the State no longer has any obligation to provide additional funding to meet the minimum funding guarantee.

## Key Factors for a School District Turning Basic Aid

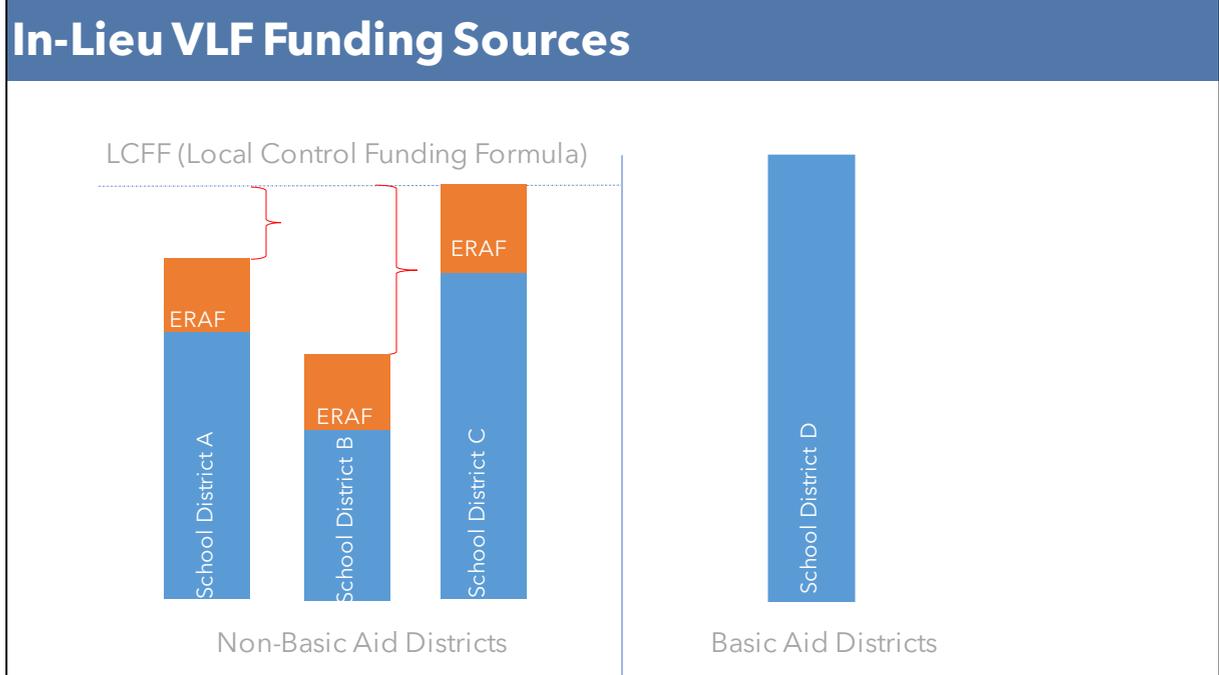


- School District A is still non-BA, but with just its ERAF entitlement, it now has sufficient funding to meet its minimum funding guarantee. The State does not have to provide any additional funding to this district despite the fact that it is still non-BA. [Note: this is the case for all non-BA districts in San Mateo County.]
- School District B still requires additional State funding to meet its minimum funding guarantee, but the gap that the State must fill is reduced.
- Because of the change in dynamics with School Districts A and C, the full ERAF entitlement is no longer needed to fund these districts to their LCFF. By law, after funding non-basic aid schools to their LCFF (as well as certain special education costs), the unneeded portion of ERAF (termed “excess ERAF” under the statute) must be returned to the contributing jurisdictions from which that revenue was originally shifted. In other words, that portion of ERAF must be returned to the cities, special districts, and County. For this reason, locally we call this “Returned ERAF”.
- Note: ERAF is returned to the contributing taxing agencies only after all school districts are funded to at least their LCFF amount. School districts that meet their LCFF level through their own property tax apportionment (i.e., basic aid districts) cannot receive ERAF by law, and those funds must be returned to the contributing agencies.

## In-Lieu Vehicle License Fee (VLF)

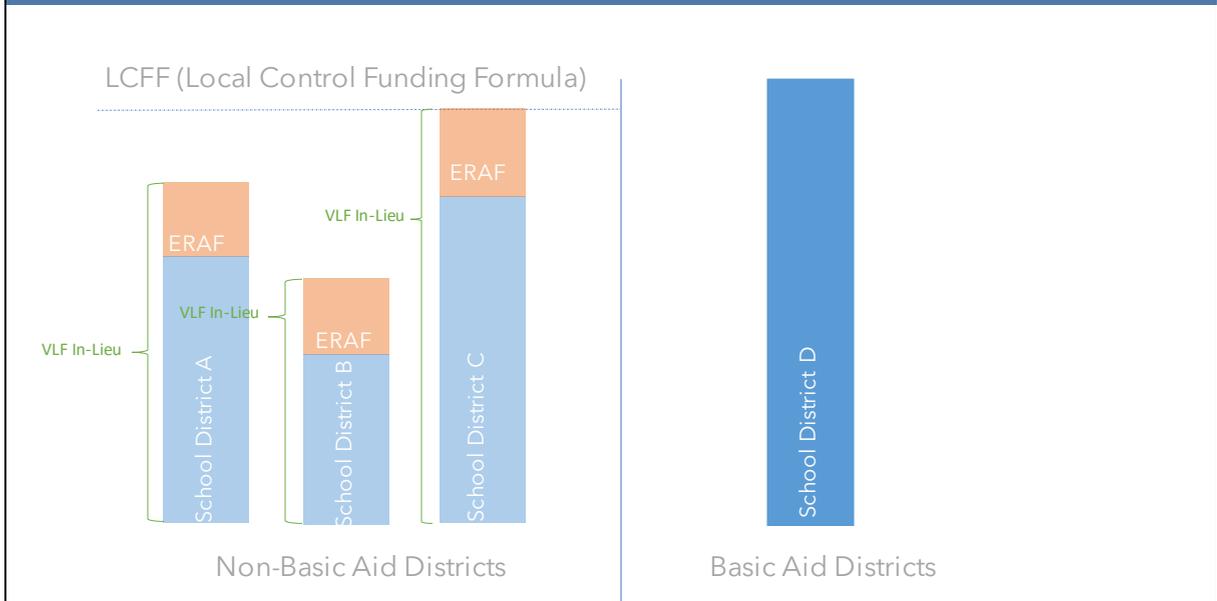
- Part of budget compromise of 2004
- Created State's In-lieu VLF payment obligation to counties and cities (VLF no longer tied to vehicle registration collected by State)
- VLF growth tied to local assessed value growth

- The VLF (annual amount paid to register a vehicle in California) has been a long-standing traditional source of funding for local government. As a key component of local jurisdictions' general fund budgets, it funds core local services including public safety, health, housing, and other critical local services.
- The 2004 State budget compromise involved a complex set of measures and tradeoffs both at the State and local levels needed to address the State budget deficit, the full scope of which is beyond the focus of this presentation. Significantly, the 2004 budget compromise included the VLF swap statute, which fundamentally revised the VLF framework.
- Key components for our purposes:
  - The statute de-coupled the VLF revenues for local jurisdictions from the actual amounts received by the State for vehicle registration.
  - The funding obligation to local governments became known as the "in-lieu" VLF payment. It is payable to local jurisdictions from the property tax and ERAF entitlements of non-BA school districts (who are in turn, backfilled by the State). This statutory funding mechanism is described in the next slides.
  - The statute expressly provides that the VLF swap shall not reduce Returned (Excess) ERAF.
  - The growth of the in-lieu VLF payment was tied to the growth rate of local assessed values.



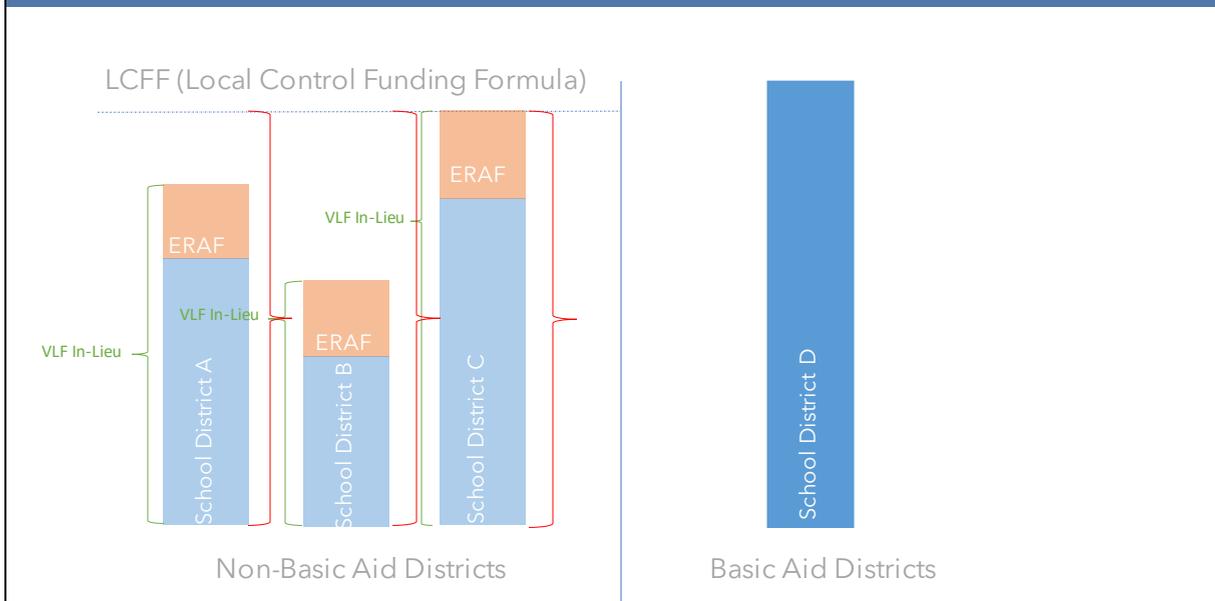
- This graphic depicts how the State meets its in-lieu VLF funding obligation through the funding for local school districts.
- We start with the basic model of K-12 local school funding, where non-BA districts receive their property tax apportionments, ERAF entitlements, and the State additional funding to meet their LCFF.

## In-Lieu VLF Funding Sources



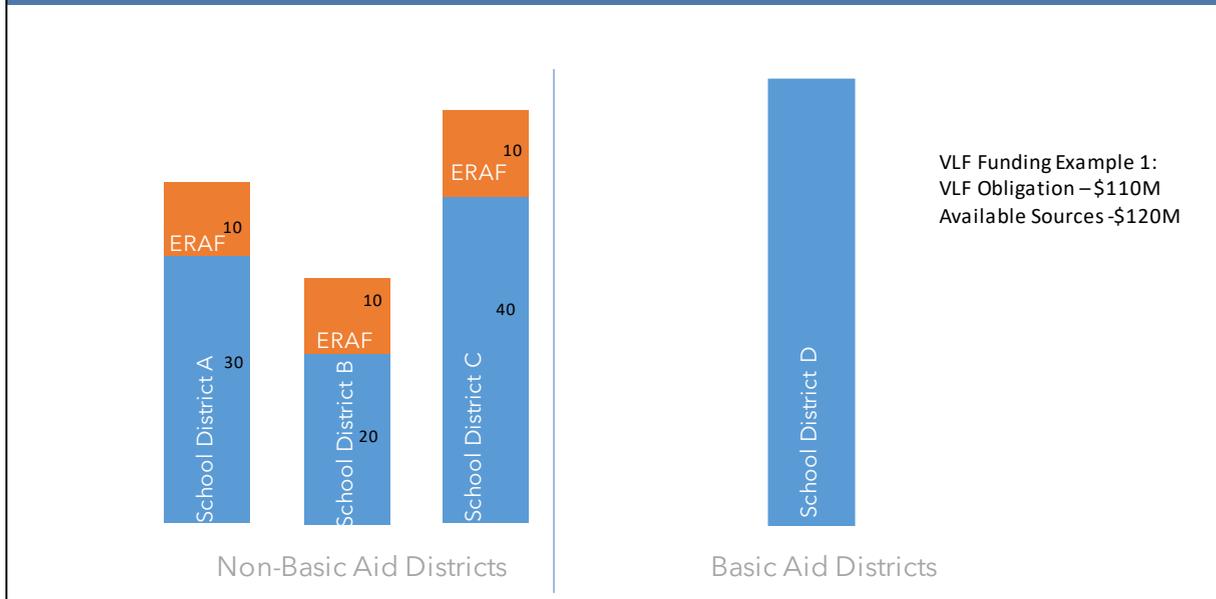
- Under the VLF statute, the local auditor-controller, who administers the local property tax system, uses the property taxes and ERAF entitlements that would otherwise go to non-BA districts to pay the State’s in-lieu VLF obligation to the cities and county (green bracket in this graphic).

## In-Lieu VLF Funding Sources

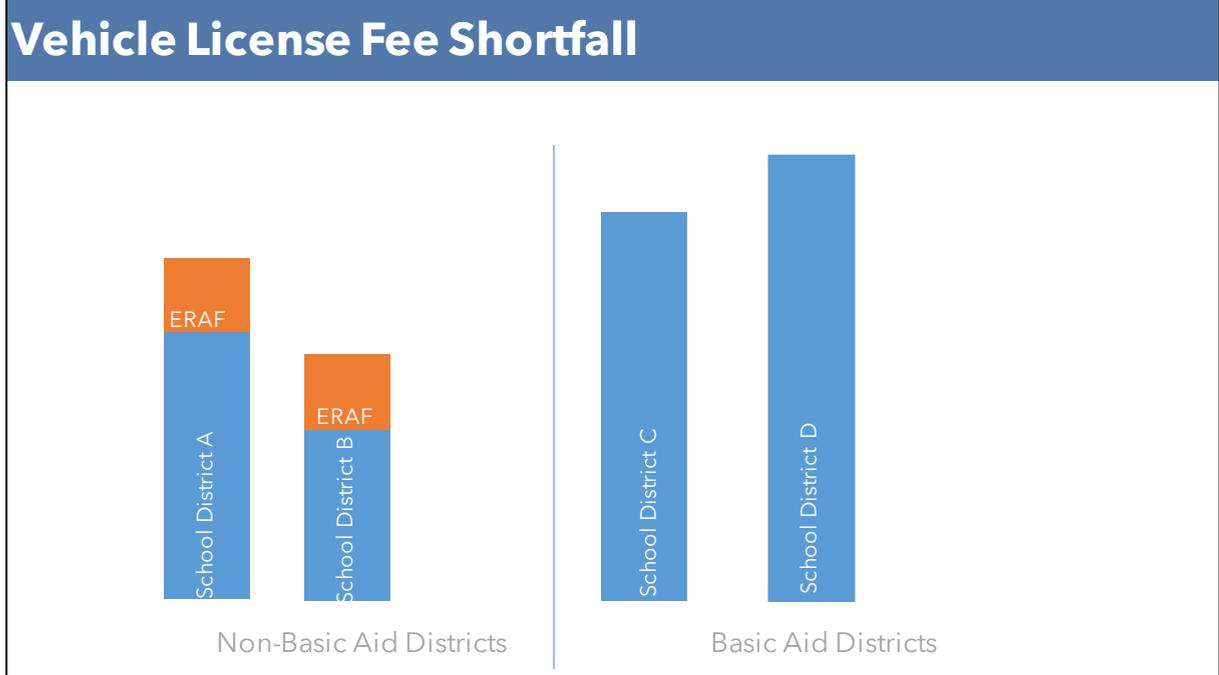


- The State then backfills those districts dollar-for-dollar up to their LCFF (red brackets).
- NOTE: the non-BA school districts are held harmless in this process. Both before and after the VLF swap statute, those districts receive their full LCFF amount as guaranteed by the State under Prop. 98. They receive their minimum per-student funding guarantee in both scenarios.
- Further NOTE: Even though the VLF framework calls for the State's In-lieu VLF funding obligation to be paid in the first instance from non-BA districts' ERAF and property taxes, the State still effectively pays the full in-lieu VLF amount to cities and counties because the State backfills the non-BA schools for every dollar of their property taxes and ERAF that is used to pay the in-lieu VLF obligation.

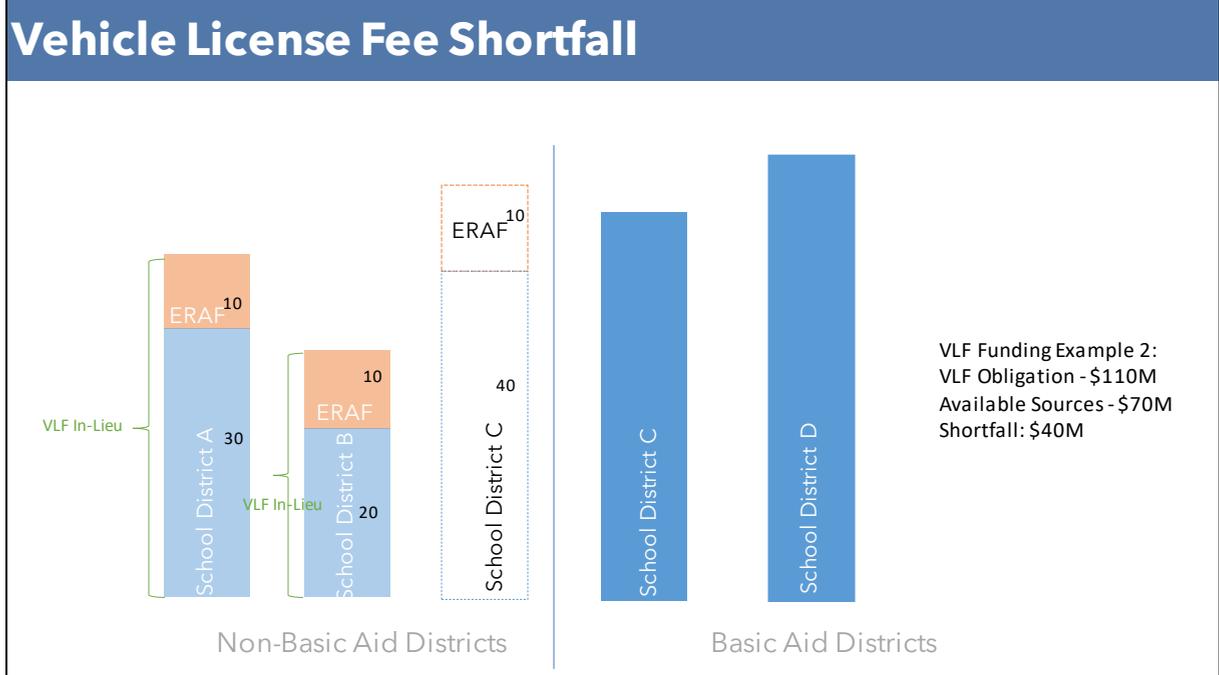
## Vehicle License Fee Shortfall



- In San Mateo County and 2 other counties, there is a shortfall created when the available funding sources in the VLF swap statute are insufficient to fully cover the State’s in-lieu VLF payment obligation to cities and counties. This is due in part to the phenomenon of districts turning basic aid. Two examples will demonstrate conceptually how this works.
- In example 1, the in-lieu VLF obligation of \$110M is paid through the property taxes and ERAF of non-BA districts (A, B, and C), which are more than sufficient to satisfy the obligation.



- In example 2, School District C has turned basic aid through the dynamics described earlier in this presentation.



- Now, because School District C's property taxes and ERAF are no longer available to fund the VLF obligation, in example 2 there is only \$70M in available sources under the VLF framework, resulting in a \$40M shortfall.
- NOTE: While VLF and excess ERAF are two distinct sources of revenue to which counties and cities are entitled, both are impacted by a school district turning basic aid. However, as this graphic shows, the loss in available revenue sources to fund the VLF obligation caused by a district turning basic aid (in this example, \$50M) is greater than any impact on excess ERAF (here, \$10M).

## What Happens When There Is a VLF Shortfall?

- The VLF Swap Statute does not specify how the State funds its in-lieu VLF obligation when the specified funding sources are insufficient to fully satisfy amounts owed to the cities and county.
- If there is a shortfall, the county auditor controller files a claim with the State/DOF requesting payment to county and cities
  - Statewide, only 3 counties (and cities within) experience VLF shortfalls: San Mateo, Alpine and Mono
  - All other 55 counties (and cities within) receive their full annual VLF revenue amounts from the State through the funding mechanism specified in the VLF Swap Statute
- Historically, the State has always made counties and cities whole by reimbursing any in-lieu VLF shortfalls through a special appropriation in the State budget.
- In years when the State has failed to include VLF shortfall amounts in the proposed budget, the counties and cities have relied on their state delegations to advocate for the inclusion of the reimbursement in the enacted State budget.