MEMORANDUM

TOWN OF PORTOLA VALLEY

TO: Mayor and Members of the Town Council

FROM: Nick Pegueros, Town Manager

DATE: June 12, 2013

RE: **2013-14 Appropriations Limit Calculation**

RECOMMENDATION

It is recommended that the Town Council receive staff's report on the calculation of the Appropriations Limit which corrects previous overstatements of revenues subject to the Appropriations Limit.

BACKGROUND

California Law requires each public agency to calculate and adopt its Appropriations Limit for each fiscal year. This requirement stems from the 1978 passage by the voters of Proposition 4, with subsequent modification in 1990 by the passage of Proposition 111. The Appropriation Limit creates a restriction on the amount of revenue that can be appropriated in any fiscal year. The Limit is based upon actual appropriations during 1977-1978, adjusted each year for inflation and population growth. Not all revenues are restricted by the Limit, only those that are referred to as "proceeds of taxes." Additionally, certain types of appropriations do not count against the Limit, including the costs of voter-approved debt, court and Federal mandates, and qualified capital outlay.

In order to determine whether an agency is within its Limit for any given fiscal year, the agency must determine its anticipated revenues that qualify as proceeds of taxes. The allowed cost exclusions are then deducted from the total proceeds of taxes. The resulting number is the appropriations subject to the Limit for the fiscal year. This is compared with the actual adopted Limit in order to determine an agency's position over or under the Limit.

An agency may not appropriate any proceeds of taxes received in excess of its Limit. An excess may be carried forward for one year. If an excess still exists at the end of two years, it must be returned to the taxpayers through tax reductions or rebates. Alternatively, a majority of the local voters may approve an "override" to increase the Limit for a four-year period. Very few agencies have reached or exceeded their Appropriations Limit. Those agencies that do have usually experienced a significant increase in tax base through new and extensive development, which would outstrip increases in inflation or population.

DISCUSSION

Town staff computes the Appropriations Limit for the upcoming year as part of its budget preparation process. It is standard practice for staff to use prior year calculations as the template for new calculations. In the 2013-14 calculation of the Appropriations Limit, staff took a fresh look at the calculation and found that the Town's calculations have historically overstated the revenues that are subject to the Limit. When this overstatement is corrected in the 2013-14 calculation of the Limit, the Town is projected to be under the Limit, and is not in danger of exceeding its Limit in subsequent years.

The calculation for 2013-14 properly excludes revenues that are not subject to the Limit as provided for in Article XIIIB of the California State constitution. Three different overstatements were found in prior year calculations. Those overstatements are detailed below:

<u>Capital Outlay Funds</u>
As detailed below, revenues subject to the Limit were overstated by $475,000 for monies that are dedicated to capital outlay either in the current period or in future periods. Capital outlay funds are explicitly exempt from the Limit. The overstated revenues include:

1. UUT revenue for open space of $245,000 – The intent of this revenue is to acquire and improve land for preservation as open space. In any one year, the open space UUT is insufficient to provide for the acquisition of land in Portola Valley. Therefore, the funds are put into a reserve for future use. Given that the sole intent of these funds is to eventually purchase a capital asset (land) and possibly make improvements to that land for preservation as open space, this revenue is exempt from the Limit as a reserve for future capital outlay.

2. Measure A revenue of $230,000 – The purpose of this revenue is to provide for roadway capital improvements and the Town generally expends these funds as part of the annual roadway improvement program. This revenue is therefore exempt from the Limit on the basis that it is either used for qualified capital outlay in the current period or reserved for future capital outlay.

<u>Restricted Taxes and Grants</u>
As detailed below, revenues subject to the Limit were overstated by $111,000 for monies that are provided by the State to offer a higher level of local service. These are not subject to the Limit because the funds are fully restricted to a specific purpose. The overstated revenues include:

1. Public safety sales tax of $11,000 – This revenue has historically been included in the calculation as subject to the Limit incorrectly. The nature of this revenue is restricted to enhancing public safety services and restricted revenues are exempt from the Limit.

2. COPS/SLESA grant of $100,000 – This grant has historically been classified as a tax subject to the Limit incorrectly.

Federal Mandate Appropriations

The Town's appropriations for compliance with federal mandates such as Social Security, Medicare, unemployment insurance, increased postage rates, the Fair Labor Standards Act, and the Affordable Care Act, etc., should be treated as a reduction to the taxes subject to the Limit. Historically, the Town has not made this reduction to the taxes subject to the Limit which, for 2013-14, are projected to total $92,000. This oversight has resulted in the Town overstating the revenues subject to the Limit.

2013-14 Appropriations Limit

The attached worksheet demonstrates the amount that the Town is under the Limit starting in 2013-14 and projected through 2018-19. As demonstrated in the calculation, the Town's total revenue subject to the Limit is lower than the Limit by $114,000. The divergence between the Limit and the revenues subject to the Limit is projected to grow over time due to the following factors:

1. The Annual Adjustment Factor, which is a combination of inflation and change in population, is projected to increase annually by 5%. This projection is low if the economy goes into a phase of inflation or the population of San Mateo County grows in response to the improved economy. For 2013-14 the adjustment factor is 6.27%.

2. State raids on local coffers continue to be a concern with the Town anticipating the loss of $137,000 in Excess ERAF funds as a result of recent changes in how the ERAF pool is allocated. This loss has been factored into the projections starting in 2014-15 with the loss of $30,000 and increasing to a total annual loss of $137,000 in 2017-18. However, the Town may see this revenue loss begin as early as 2013-14.

3. Property tax revenue is unlikely to grow at the 6% annual growth rate assumed in the attached worksheets. For projection purposes the growth rate of the Town's largest revenue was set at a rate higher than the annual adjustment factor for the Limit in an effort to provide conservative projections. The risk, of course, is that the increase in property taxes will sufficiently exceed the annual adjustment factor for the Limit over multiple years. However, it is important to remember that Proposition 13 limits the annual

across-the-board increase in property taxes to 2%. Any growth above 2% is the result of reassessed properties due to a change in ownership or properties with substantial building improvements, namely a major remodel. While it is conceivable that property taxes could grow at a rate greater than 6% in one year, it is unlikely that such a high growth rate would be sustained over several consecutive years. Therefore, for each year that the property taxes grow less than 6%, the divergence between the Limit and the revenues subject to the Limit will grow.

4. The true impact of the Affordable Care Act is unknown at this time and cost may be considerably higher than those factored into the projections. To the extent that the federally mandated costs exceed projections, the divergence between the Limit and the revenues subject to the Limit will grow.

5. Sales tax revenues have fluctuated dramatically over the past five years ranging from $93,000 to $174,000 with the average being $140,000 per year. The projections assume strong sales tax revenue base $172,000 and annual growth of 5%. Given the Town's limited sales tax bases the 5% assumption is aggressive.

6. Property transfer taxes have fluctuated dramatically over the past several years ranging from $40,000 to $100,000 with an average being $70,000 per year. With a recovery in the real estate market, the projections assume a 50% increase in this revenue beginning in 2014-15 and remaining steady through the projected years. However, given the fluctuation in this revenue historically, future budgets are unlikely to include such an aggressive projection.

In summary, the updated calculations of the Appropriations Limit include a correction of overstated revenues on a prospective basis beginning in 2013-14. Based on the calculations for 2013-14, the Town's revenues subject to the Limit will not exceed the Limit. To that end, while the Town has required voter approval of an Appropriations Limit override for prior budget years because the Town projected exceeding its limit, such an override is not necessary beginning as early as 2013-14.

ATTACHMENTS

1. Appropriations Limit Calculation worksheet

Town of Portola Valley
Appropriations Limit Calculation
6/7/2013

ATTACHMENT 1

		2013-14 Proposed Budget	2014-15 Projected	2015-16 Projected	2016-17 Projected	2017-18 Projected	2018-19 Projected
	I. Calculation of Appropriations Limit (Limit)						
	A. Prior fiscal year Limit (unadjusted by voter approved override)	$ 2,693,414	$ 2,862,178	$ 3,005,287	$ 3,155,551	$ 3,313,329	$ 3,478,995
	B. Annual Change Factors						
	1 Cost of living adjustment factors						
	California Per Capita Personal Income factor (CPCPI)	1.0512					
	2 Population adjustment factors (Pop)	1.0109					
*	C. Authorized Adjustment Factor (AAF)	1.0627	1.0500	1.0500	1.0500	1.0500	1.0500
	CPCPI * Pop						
	D. Fiscal year Limit, as adjusted by the AAF	$ 2,862,178	$ 3,005,287	$ 3,155,551	$ 3,313,329	$ 3,478,995	$ 3,652,945
	Prior year limit * AAF						
	II. Estimated Tax Proceeds Subject to the Limit						
	A. Property taxes						
*	1 Current secured & unsecured	$ 2,022,158	$ 2,098,267	$ 2,193,164	$ 2,295,253	$ 2,379,969	$ 2,522,767
	2 Homeowner's property tax exemption backfill	5,400	5,500	5,500	5,600	5,600	5,700
	3 Subtotal all property taxes	2,027,558	2,103,767	2,198,664	2,300,853	2,385,569	2,528,467
	B. Other taxes						
*	1 General purpose utility users tax (UUT)	553,554	567,393	581,578	596,117	611,020	626,296
	2 General sales taxes	172,000	175,000	183,750	192,938	202,584	212,714
	3 Business taxes	85,000	90,000	95,000	95,000	95,000	95,000
	4 Property transfer taxes	100,000	150,000	150,000	150,000	150,000	150,000
	5 Motor vehicle in lieu	-	-	-	-	-	-
	6 Subtotal all other taxes	910,554	982,393	1,010,328	1,034,055	1,058,604	1,084,009
	C. Revenues previously reported as subject to the Limit but exempt						
	1 Open space fund UUT, dedicated to open space capital outlay	245,934	250,853	255,870	260,987	266,207	271,531
	2 Measure A sales tax dedicated to roadway capital improvements	230,000	234,600	239,292	244,078	248,959	253,939
	3 Public Safety sales tax restricted to public safety (Prop 172)	11,780	12,016	12,256	12,501	12,751	13,006
	4 COPS/SLESA grant restricted to public safety	100,000	100,000	100,000	100,000	100,000	100,000
	5 Subtotal other revenues exempt from the Limit	587,714	597,468	607,418	617,566	627,917	638,476
	D. Total estimated tax proceeds	3,525,826	3,683,629	3,816,409	3,952,474	4,072,090	4,250,951
*	E. Adjustments to tax proceeds subject to the Limit						
	1 Revenues exempt from the Limit, see section I.C.	(587,714)	(597,468)	(607,418)	(617,566)	(627,917)	(638,476)
	2 General capital outlay funded by taxes	(110,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
*	3 Federal mandates (SocSec, Medicare, FLSA O/T, ACA)	(92,256)	(106,292)	(109,480)	(112,765)	(183,948)	(255,232)
	5 Interest earned from taxes	12,000	13,000	14,000	15,000	16,000	17,000
	5 Subtotal all adjustments	(777,970)	(790,760)	(802,898)	(815,331)	(895,865)	(976,708)
	F. Adjusted estimated tax proceeds subject to the Limit	$ 2,747,856	$ 2,892,869	$ 3,013,511	$ 3,137,143	$ 3,176,225	$ 3,274,244
	Amount Over/(Under) the Limit	**$ (114,322)**	**$ (112,418)**	**$ (142,040)**	**$ (176,186)**	**$ (302,770)**	**$ (378,701)**

Notes:

I.C. - Between 1979-80 and 2012-13, the Median AAF = 1.0557; the Average AAF = 1.0516

II.A.1 - Assumes gradual loss of Excess ERAF beginning in 2014-15 and going to $0 in 2017-18; 6% annual projected growth; 2012-13 budget adjusted by Prop 1A loan that was budgeted in 2009-10 and should have been recorded as a receivable.

II.B.1 - Assumes no increase of general purpose UUT in 2014-15 and 2.5% annual growth each projected year

II.E - Based on a reevaluation of the town's past calculations, the items listed in this category more completely represent the allowed adjustments to tax proceeds subject to the Limit per Section 13b of the California State Constitution.

II.E.3 - Adds the Affordable Care Act as a federal mandate - dependent care coverage extended to 26 years old for 18 months; assumed 6% increase in premiums beginning in 2014 as est. by CalPERS to implement ACA; assumes ACA 40% excise tax hitting CalPERS medical plans on 1/1/18

* = see notes section