

**SUBMITTAL TO THE BOARD OF SUPERVISORS  
COUNTY OF RIVERSIDE, STATE OF CALIFORNIA**

201 A



**FROM:** Executive Office

**SUBMITTAL DATE:**  
November 22, 2004

**SUBJECT:** Wildomar Municipal Service and Initial Fiscal Review: Contract Amendment Resulting from State Law Changes to the Vehicle License Fees (VLF)

**RECOMMENDED MOTION:** That the Board:

1. Receive and file the attached report regarding VLF distribution and incorporations.
2. Approve the attached contract amendment to the Professional Services Agreement with MuniFinancial for its work on the Wildomar Municipal Service and Initial Fiscal Review and authorize the Chairman to sign the amendment on behalf of the County.
3. Authorize the payment of \$3500 in 1<sup>st</sup> District DA Public Facilities Funds for the contract amendment.

**BACKGROUND:** On November 25, 2003, the Board of Supervisors approved a Professional Services Agreement with MuniFinancial to prepare a Municipal Service and Initial Fiscal Review (MS/IFR) of the Wildomar community. The study was funded jointly by the County, City of Murrieta and Local Agency Formation Commission (LAFCO).

(cont. page 2)

*Katherine Gifford*  
Katherine Gifford, Principal Management Analyst

**FINANCIAL  
DATA**

Current F.Y. Total Cost:	\$ 3500	In Current Year Budget:	Yes
Current F.Y. Net County Cost:	\$ 0	Budget Adjustment:	No
Annual Net County Cost:	\$ 0	For Fiscal Year:	04-05

<b>SOURCE OF FUNDS:</b> 1 <sup>st</sup> District DA Public Facilities Funds – Fund 30556	<b>Positions To Be Deleted Per A-30</b>	<input type="checkbox"/>
	<b>Requires 4/5 Vote</b>	<input type="checkbox"/>

**C.E.O. RECOMMENDATION:** Approve

**County Executive Office Signature** *Bronda King*

Dept's Recomm.:  Consent  Policy  
Per Exec. Ofc.:  Consent  Policy

Prev. Agn. Ref.: 11/25/03 (3.59) | District: 1 | Agenda Number:

3.3

## **Wildomar Fiscal Analysis and Municipal Service Review Amendment**

### **Page 2**

While the analysis was being prepared, the State Legislature altered the formula for allocating the Vehicle License Fees (VLF), causing a significant decrease in VLF revenues to cities from annexations, at least initially, and a permanent decrease in VLF revenues to newly incorporated cities. Attachment A, a report by Coleman Advisory Services, summarizes the impact of the VLF adjustment on annexations and new incorporations. The new law (Revenue and Taxation Code sec 11005.3) does not provide the VLF revenue bump (three times registered voters over the first seven years) or property tax backfill to cities that incorporate after August 5, 2004.

Historically, the VLF adjustment was paid to newly incorporated cities from the cities' VLF fund. LAFCO, the Executive Office and the 1<sup>st</sup> District's staffs have been in contact with Senator Benoit's office, the League of Cities, and other state offices to determine if or when there will be a legislative fix for this statewide issue and what funding source could be used to address this loss. To date, no resolution has been put forth.

The draft MS/IFR was made available to the community on October 12, 2004 and a workshop was conducted in the community on October 28, 2004. The consultant is responding to community comments on the draft document. These responses will be available at the LAFCO hearing on December 9, 2004.

A copy of the draft MS/IFR is available at [www.LAFCO.org](http://www.LAFCO.org) under "Quick Links. Key findings of the report include:

1. Without a change to the VLF and/or new tax revenues, the MS/IFR found that a new city was not fiscally viable for ten years.
2. Annexing southern Wildomar was initially negative but fiscally viable within five years.
3. Initially, the net revenue for the County is negative whether the area annexes or incorporates. (An accompanying F11 includes a letter for the Board's consideration that identifies the County's concerns with the proposed annexation. Incorporation would be subject to revenue neutrality negotiations.)

The contract amendment (Attachment B) cost of \$10,000 will be paid from the remaining fund balance (\$1500), LAFCO (\$1500), City of Murrieta (\$3500) and County of Riverside 1<sup>st</sup> District DA funds (\$3500). The contract amendment is needed to address the additional costs resulting from the VLF adjustment to the report, preparing responses to community comments, and other support costs (advertising and GIS) for the project. The LAFCO Commission and Murrieta City Council have already committed to the additional funding.

## The VLF for Property Tax Swap of 2004 Problems for Annexations and New Incorporations

22 September 2004

In August the California Legislature approved a VLF for property tax swap as a part of a state-local budget agreement. The swap is discussed in "The VLF for Property Tax Swap of 2004: Facts for Local Officials" at <http://www.californiacityfinance.com/VLFswapNtakeFAQ.pdf>. Late changes in the legislation implementing the swap provide inadequate funding for future annexations and incorporations.

### I. VLF and Annexations - Prior Law

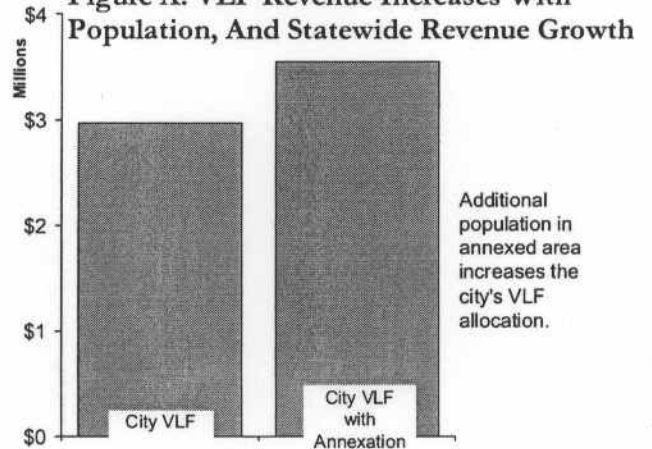
Under the law in effect prior to July 1, 2004, the city share of Motor Vehicle License Fee (MVLF) revenues, including any backfill from the state general fund, is allocated in proportion to population.<sup>1</sup> As a city's population grows relative to the statewide population in cities, the city's share of VLF revenues grows. In addition, as the taxable value of automobiles grew each year, total VLF revenue (including general fund backfill) grew over time, increasing the total pool of revenue to be allocated each year.

These additional revenues to the city essentially came from the growing statewide pot of city MVLF revenue, including the VLF backfill from the state general fund. Because county MVLF allocations came from a county MVLF pot, annexations did not alter MVLF allocations to counties.

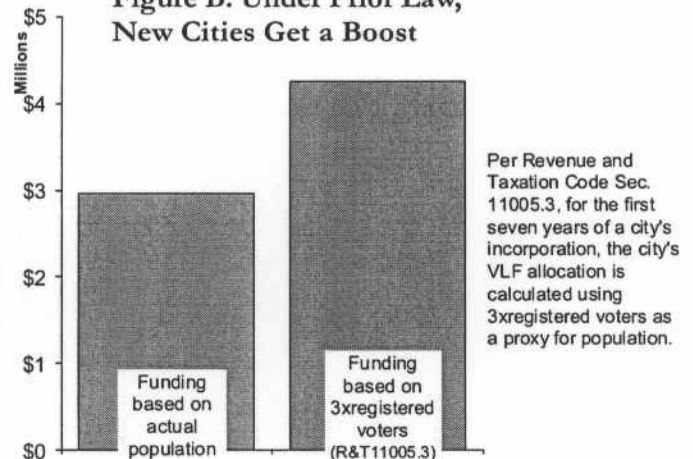
### II. VLF and New Incorporations – Prior Law

Under the law in effect prior to July 1, 2004, a newly incorporated city receives its allocation of VLF revenues based on three times the number of registered voters in the city at the time of incorporation.<sup>2</sup> The city receives VLF on this basis for its first seven years.<sup>3</sup> If the city annexes an area, the actual population in that area is added to the three times registered voters figure for the purpose of calculating the city's MVLF allocation. The three times registered voters basis provides these cities with a 15% to 150% boost in MVLF revenues depending

**Figure A: VLF Revenue Increases With Population, And Statewide Revenue Growth**



**Figure B: Under Prior Law, New Cities Get a Boost**



<sup>1</sup> For a more thorough discussion of VLF revenues and allocations under prior law, see "The VLF for Property Tax Swap of 2004: Facts for Local Officials" at <http://www.californiacityfinance.com/VLFswapNtakeFAQ.pdf>.

<sup>2</sup> Revenue and Taxation Code Section 11005.3

<sup>3</sup> With certain exceptions. See Revenue and Taxation Code Section 11005.3.

on the proportion of registered voters in the city.

This boost in revenues to a newly incorporated city essentially came from the growing statewide pot of city MVLF revenue, including the VLF backfill from the state general fund. Because county MVLF allocations came from the county MVLF pot, new incorporations did not alter MVLF allocations to counties, and neither city nor county VLF revenues were the subject of tax sharing.

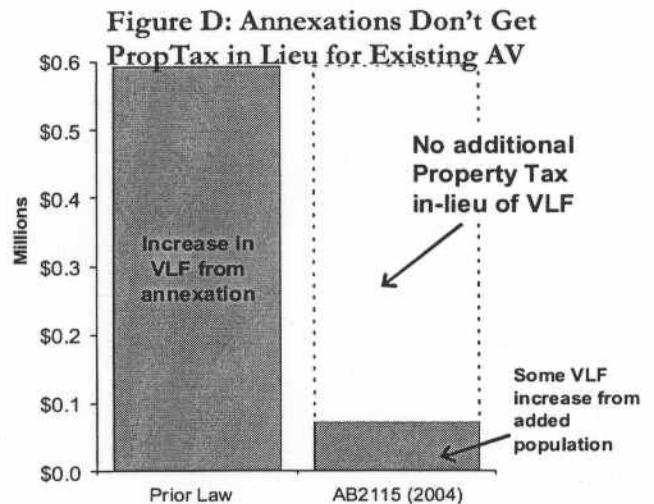
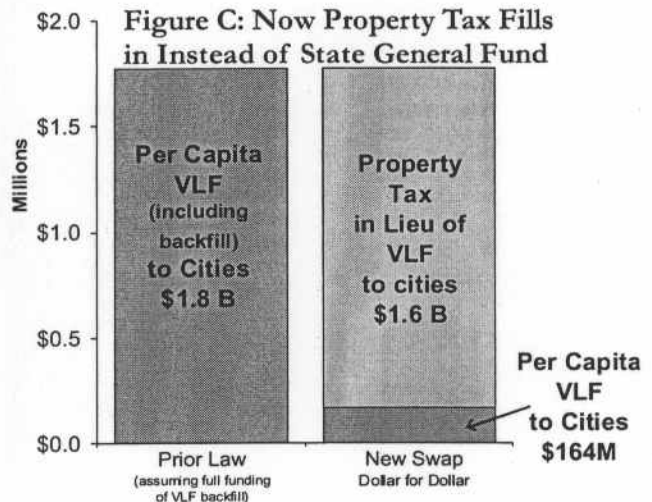
The three times registered voters allocation basis provides a proxy for population during the first few years of city's incorporation, when it is difficult for demographics officials to reach a reasonable estimate of actual population. The three-times-registered voters allocation also provides needed additional revenues to a city during its "start-up" years.

### III. The VLF For Property Tax Swap of 2004 and Annexations

AB2115 includes the provisions for the VLF for property tax swap of 2004. The changes reduce the VLF rate to 0.65%, repeal the state general fund backfill to cities and counties for reduced VLF rate, alter the allocation of the remaining VLF revenues among cities and counties, and establish reimbursement amounts in the form of additional property tax to each city and county for differences as a result of these changes.

The reduced VLF revenue and change in allocations will result in cities receiving less than 10% of the VLF revenue they would have received under prior law. The difference will come to cities in additional property tax.<sup>4</sup>

Because per capita MVLF allocations to cities under the VLF for property tax swap of 2004 are sharply reduced,<sup>5</sup> the amount of additional MVLF coming to a city as a result of new population in an annexation is also sharply reduced. But with regard to annexations, the new law does not make up for the reduced VLF. The new law specifies that the Assessed Value of an area during its first year of annexation is to be ignored for purposes of calculating growth in the city's property tax in-lieu of VLF. The effect of this is to substantially reduce the added revenues that would



<sup>4</sup> For more explanation, see "The VLF for Property Tax Swap of 2004: Facts for Local Officials" at <http://www.californiacityfinance.com/VLFswapNtakeFAQ.pdf>.

<sup>5</sup> Revenue and Taxation Code Section 97.70(c)(1)(C)(ii)(II)

come with an annexation, depending on the extent of build-out of the area upon annexation. The more fully built out the area prior to annexation, the greater the revenue loss to the annexing city.

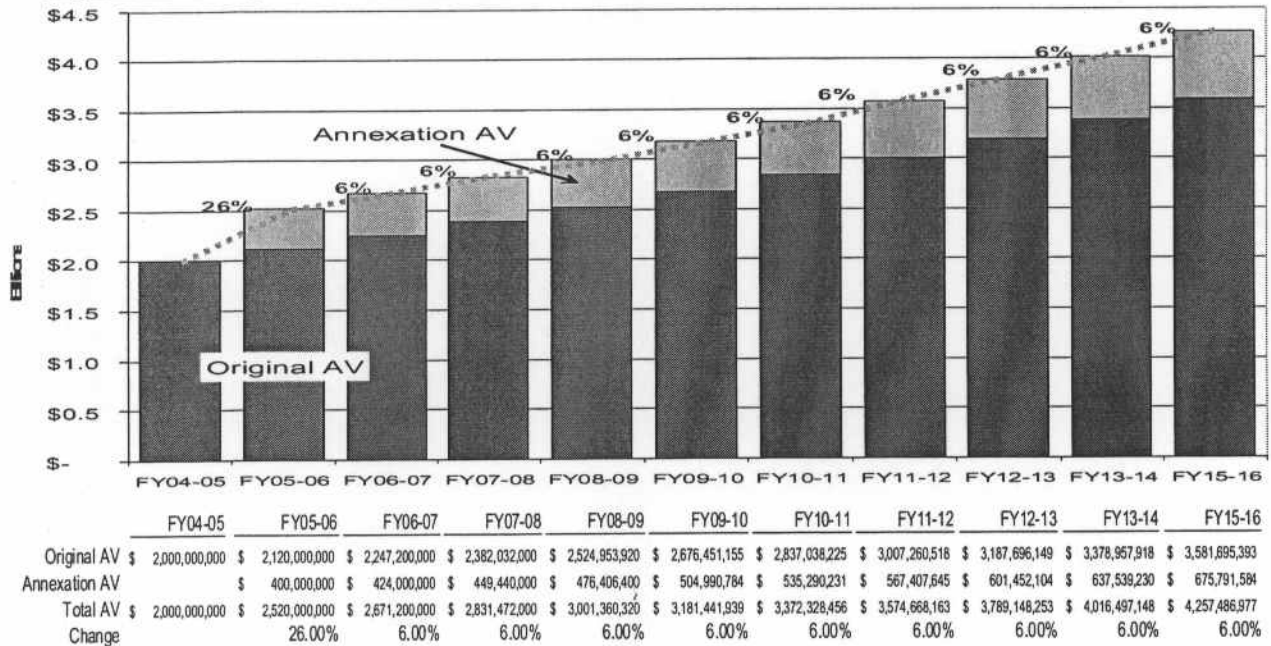
### How Growth in the Property Tax in Lieu of VLF is Calculated

AB2115 (2004) specifies that the “vehicle license fee adjustment amount” (property tax in lieu of VLF) shall be increased for each city or county by the percentage change from the prior fiscal year for the current fiscal year in gross taxable assessed valuation within the jurisdiction. But it also specifies:

For the first fiscal year for which a change in a city’s jurisdictional boundaries first applies, the percentage change in gross taxable assessed valuation from the prior fiscal year to the current fiscal year shall be calculated solely on the basis of the city’s previous jurisdictional boundaries, without regard to the change in that city’s jurisdictional boundaries. For each following fiscal year, the percentage change in gross taxable assessed valuation from the prior fiscal year to the current fiscal year shall be calculated on the basis of the city’s current jurisdictional boundaries.<sup>6</sup>

In other words, for purposes of calculating the annual increase in a city’s property-tax-in-lieu-of-VLF, the assessed valuation contained in an area upon annexation is ignored. Future growth in annexation after the first year of annexation is counted for purposes of increasing the city’s VLF reimbursement amount.

**Figure E: Example of Additional Taxable AV to a City From an Annexation<sup>7</sup>**



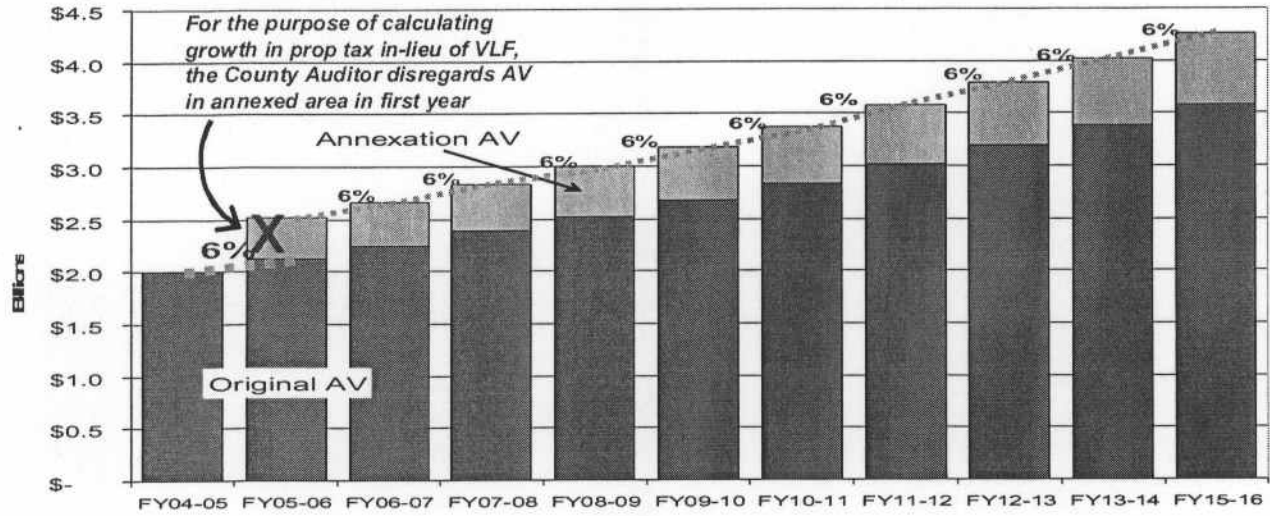
<sup>6</sup> Revenue and Taxation Code Section 97.70(c)(1)(C)(ii)(II)

<sup>7</sup> In this example, the annexed area is fully built out upon annexation.

Figure E shows an example of the effect of an annexation on the taxable AV of a city. Absent the annexed area, the AV of the city is growing at 6% per year. The annexation area which (in this example) is fully built-out, represents a 20% increase in the AV of the city and also increases in value at 6% in subsequent years.

But as Figure F shows, the initial AV in the annexed area is ignored for the purpose of calculating growth in the property tax in-lieu of VLF. In this case, because the annexation area is built-out its AV in subsequent years grows at a similar rate to the original city, and annexation results in no change in the factors used by the county auditor to determine growth in the city's property tax in lieu of VLF. The annexation does not increase the city's VLF adjustment amount from property tax, and the city receives less than 10% of the VLF it would have received under the prior law.

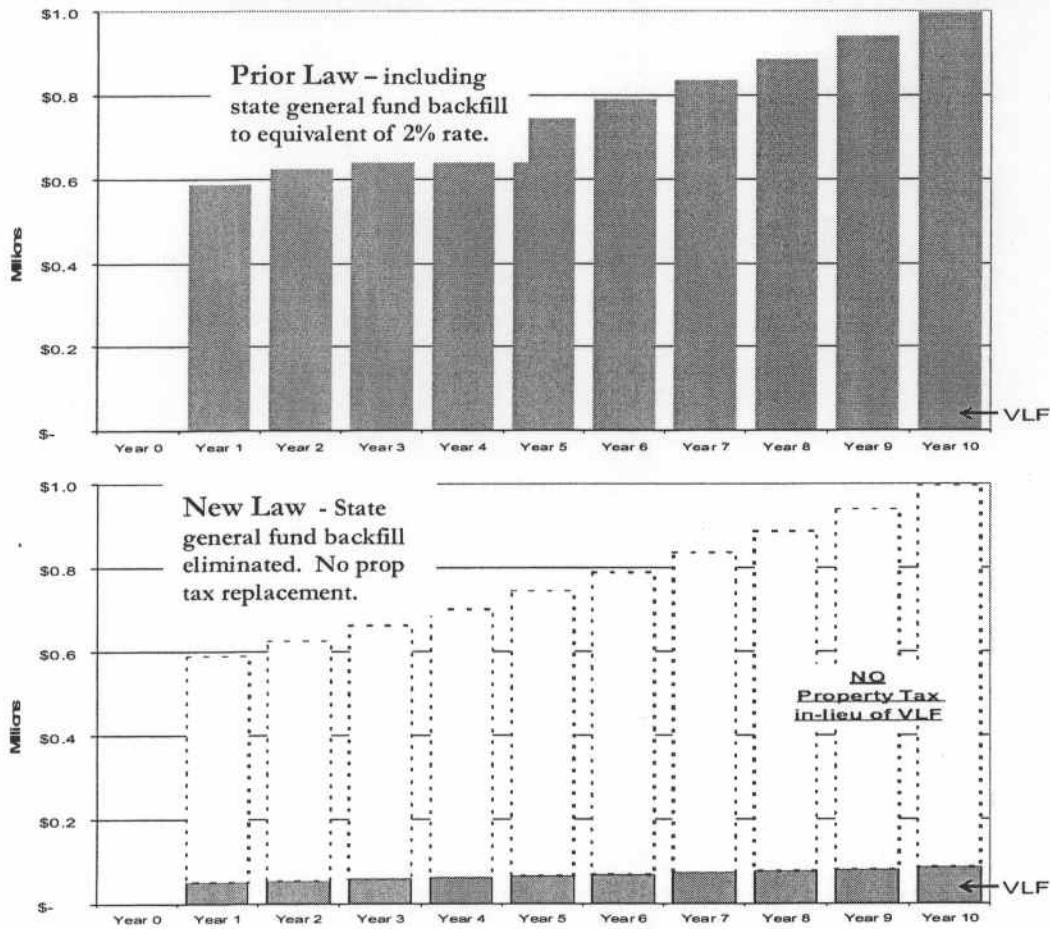
**Figure F: New Law Ignores Added Annexation AV for Calculating PropTax In Lieu of VLF**



Built-out on Annexation	FY04-05	FY05-06	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	FY12-13	FY13-14	FY15-16
Original AV	\$ 2,000,000,000	\$ 2,120,000,000	\$ 2,247,200,000	\$ 2,382,032,000	\$ 2,524,953,920	\$ 2,676,451,155	\$ 2,837,038,225	\$ 3,007,260,518	\$ 3,187,696,149	\$ 3,378,957,918	\$ 3,581,695,393
Annexation AV		\$ 400,000,000	\$ 424,000,000	\$ 449,440,000	\$ 476,406,400	\$ 504,990,784	\$ 535,290,231	\$ 567,407,645	\$ 601,452,104	\$ 637,539,230	\$ 675,791,584
Total AV	\$ 2,000,000,000	\$ 2,520,000,000	\$ 2,671,200,000	\$ 2,831,472,000	\$ 3,001,360,320	\$ 3,181,441,939	\$ 3,372,328,456	\$ 3,574,668,163	\$ 3,789,148,253	\$ 4,016,497,148	\$ 4,257,486,977
AV Change		26.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
PropTax In-Lieu of VLF Should Be	\$ 2,690,459	\$ 3,389,979	\$ 3,593,377	\$ 3,808,980	\$ 4,037,519	\$ 4,279,770	\$ 4,536,556	\$ 4,808,750	\$ 5,097,275	\$ 5,403,111	\$ 5,727,298
AV Change Absent Annexation		6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
PropTax In-Lieu Absent Annexation	\$ 2,690,459	\$ 2,851,887	\$ 3,023,000	\$ 3,204,380	\$ 3,396,643	\$ 3,600,441	\$ 3,816,468	\$ 4,045,456	\$ 4,288,183	\$ 4,545,474	\$ 4,818,203
AB2115 Change		6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
AB2115 PropTax In-Lieu	\$ 2,690,459	\$ 2,851,887	\$ 3,023,000	\$ 3,204,380	\$ 3,396,643	\$ 3,600,441	\$ 3,816,468	\$ 4,045,456	\$ 4,288,183	\$ 4,545,474	\$ 4,818,203
Difference		\$ (538,092)	\$ (570,377)	\$ (604,600)	\$ (640,876)	\$ (679,329)	\$ (720,088)	\$ (763,294)	\$ (809,091)	\$ (857,637)	\$ (909,095)

Figure G below contrasts the additional VLF revenue (including state general fund backfill) to the city from an annexation under the prior law, to the additional VLF (and lack of property tax in-lieu of VLF) under the new law.

**Figure G: Additional VLF (including State General Fund Backfill) from an Annexation<sup>8</sup>**



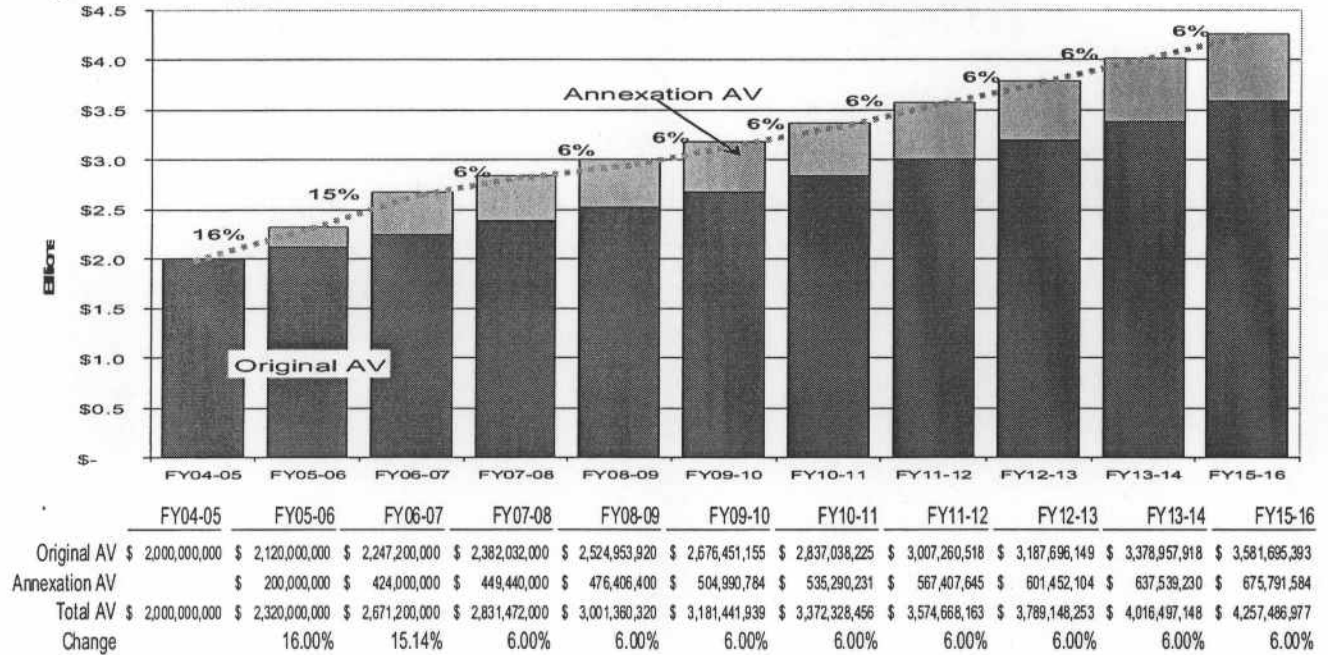
**The Effect Depends on How Developed the Area is at Annexation**

The fiscal impact of this provision of AB2115 relating to annexations varies depending the degree of build-out in an annexation area. In an area that is largely undeveloped, where the growth in taxable assessed valuation in the area will be recognized a year or more after the annexation, the fiscal impact is less. That's because the growth in AV after the first year of annexation will contribute to growth in the city's property tax in-lieu of VLF. The city loses growth in property tax in lieu of VLF from the AV that exists at the time of annexation.

Figure H below shows an area that is not fully built-out upon annexation. In this example, the AV of the area upon annexation is about 10% of the original city AV. A year after annexation, the area becomes fully built-out and doubles in AV.

<sup>8</sup> In this example, the annexed area is fully built out upon annexation.

**Figure H: Example of Additional Taxable AV to a City From an Annexation<sup>9</sup>**



Under the new law, the AV of the area in the first year of annexation is ignored for the purpose of calculating growth in the city's property tax in-lieu of VLF. But the substantial growth in the area in the following year does factor in to the growth in the city's property tax in-lieu of VLF.

<sup>9</sup> In this example, the annexed area is fully built a year after annexation. Annexation increases city taxable AV 10% upon annexation and about 10% in the second year after annexation.

Figure I: Example of Additional Taxable AV to a City From an Annexation<sup>10</sup>

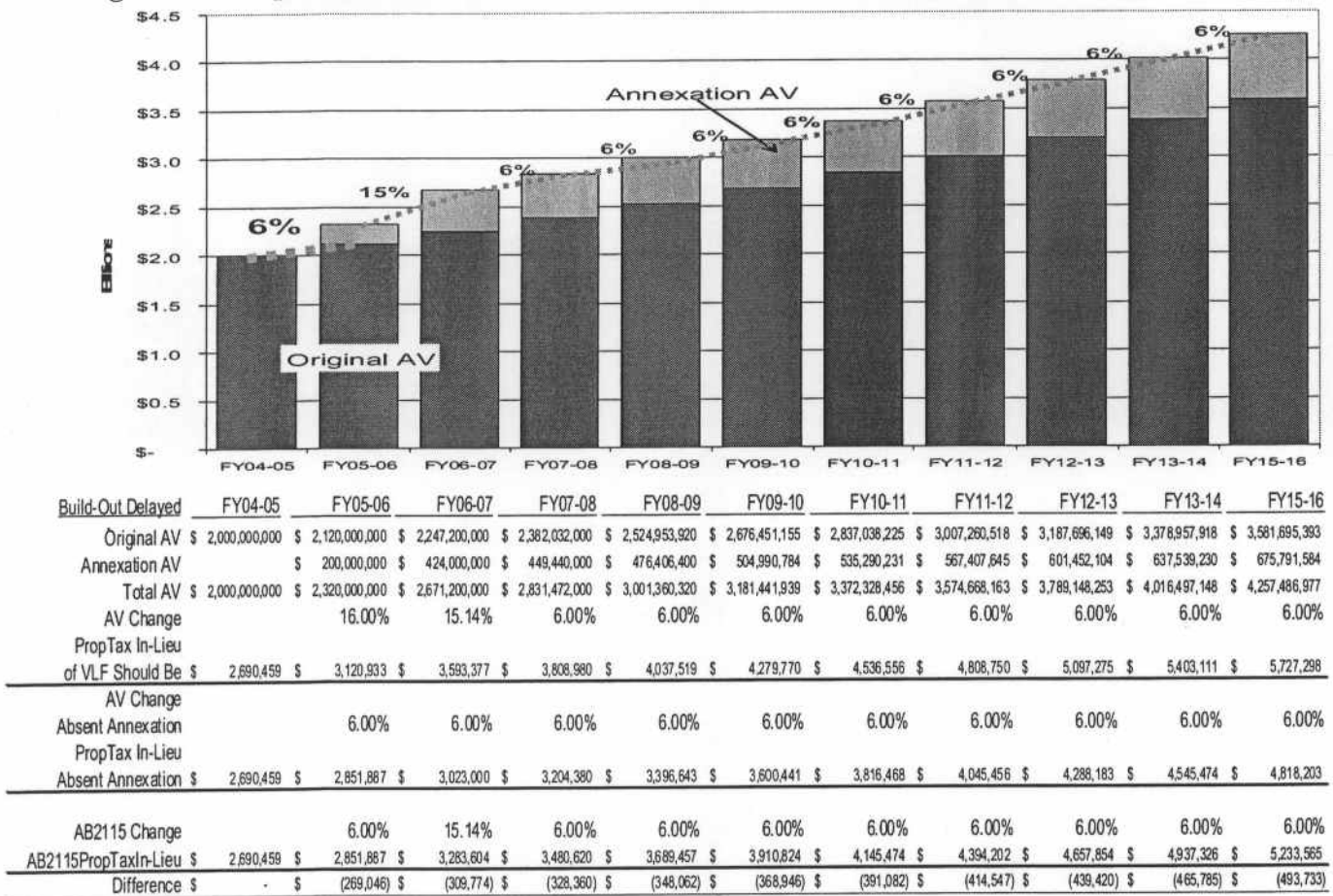
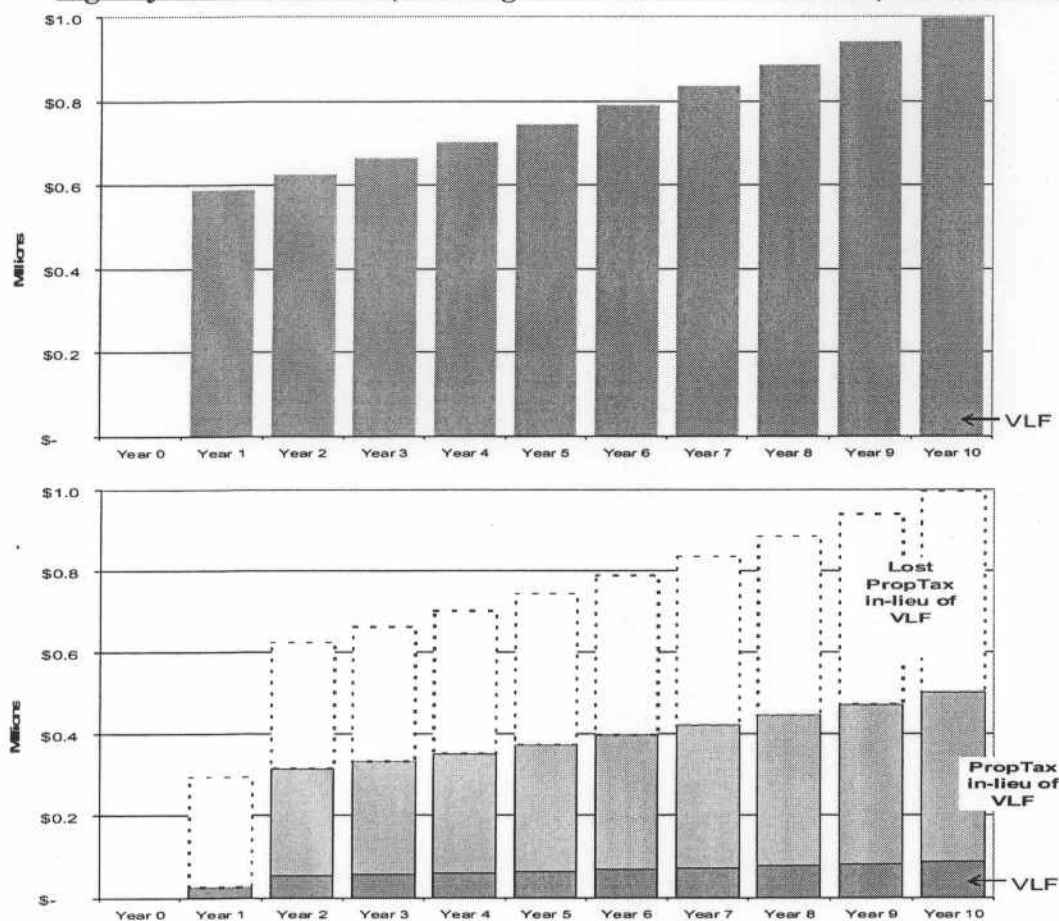


Figure J below contrasts the additional VLF revenue (including state general fund backfill) to the city from an annexation under the prior law, to the additional VLF (and lack of property tax in-lieu of VLF) under the new law. Note that the loss to the city pertains to the amount of AV in the annexed area at the time of annexation. In this case, since half the build-out AV exists at annexation, the city loses half the property tax in-lieu of VLF it should receive.

A city garners additional property tax in lieu of VLF only to the extent that development in the annexed area occurs after annexation.

<sup>10</sup> In this example, the annexed area is fully built a year after annexation. Annexation increases city taxable AV 10% upon annexation and about 10% in the year after annexation.

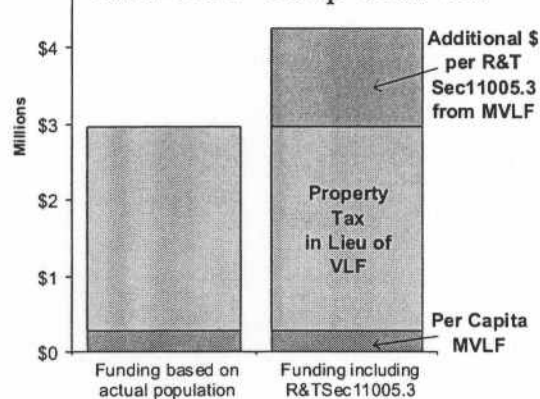
**Figure J: Additional VLF (including State General Fund Backfill) from an Annexation<sup>11</sup>**



**IV. The VLF For Property Tax Swap Of 2004 And Recently Incorporated Cities**

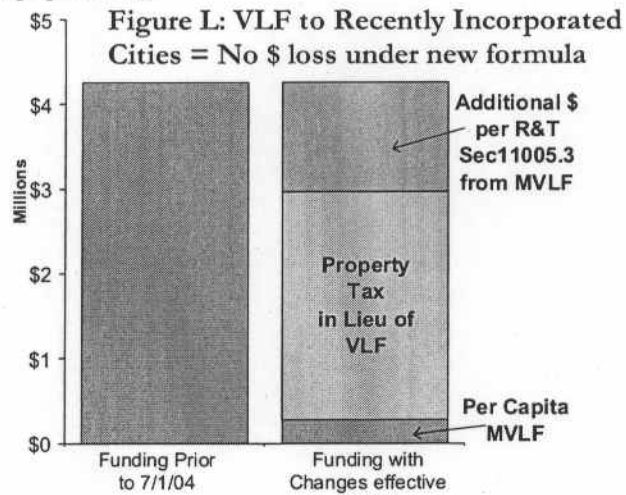
Revenue and Taxation code Section 11005(b) as contained in AB2115 of 2004 provides that recently incorporated cities receive their three times registered voters VLF “bump” entirely from the residual MVLf account, before MVLf per capita allocations are made to cities. The new law directs the State Controller’s Office to determine, for cities for whom Rev&Tax Sec 11005.3 applied on August 5, 2004, the additional amount of VLF revenue each city would receive as a result of Rev&Tax Sec 1100.5.3 (that is, with an allocation based on three-times-registered voters

**Figure K: Recently Incorporated Cities Get a “Bump” from VLF**



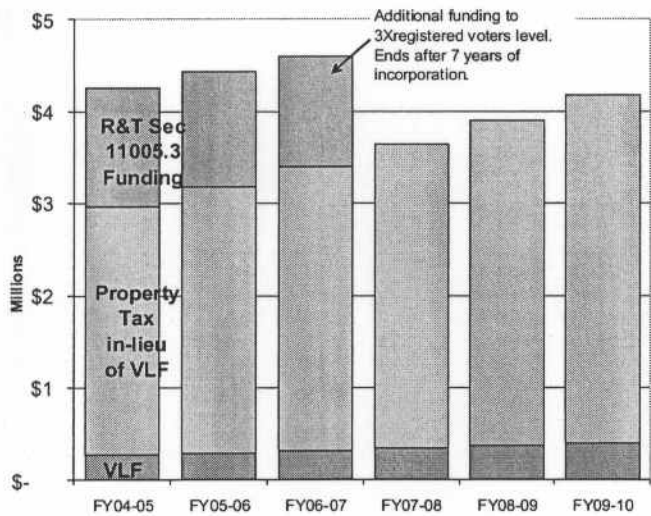
<sup>11</sup> In this example, the annexed area is fully built a year after annexation, doubling the AV of the annexed area.

versus an allocation based on estimated actual population).



In addition, these recently incorporated cities receive a per capita allocation from the residual MVLF account along with other cities, based on estimated actual population. Finally, like other cities, they will receive a “VLF adjustment amount” (property tax in lieu of VLF) amounting to the difference between their total MVLF revenues in FY04-05 and what they would have received from MVLF in FY04-05 had the prior law remained in effect.

**Figure M: After 7 Years, VLF “Bump” to Recently Incorporated Cities Ends.**



**V. The VLF For Property Tax Swap Of 2004 And New Incorporations**

Nothing in the new law directly alters past or future property tax sharing agreements or formulas among local governments. Neither county nor city VLF has been the subject of property tax sharing in the past and neither must it's successor revenues: the Property Tax in Lieu of VLF (or “VLF adjustment amount”).

### No VLF "Bump" for Future Cities

The new law provides Revenue and Taxation Code Sec 11005.3 funding (the three times registered voters basis) only to cities for whom that section applied on August 5, 2004.<sup>12</sup> Consequently, the new law does not provide this VLF revenue bump to cities that may incorporate in the future.

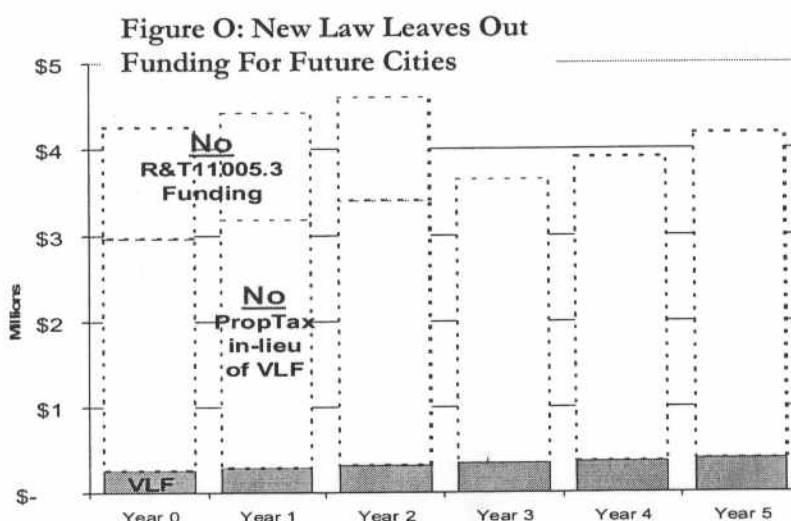
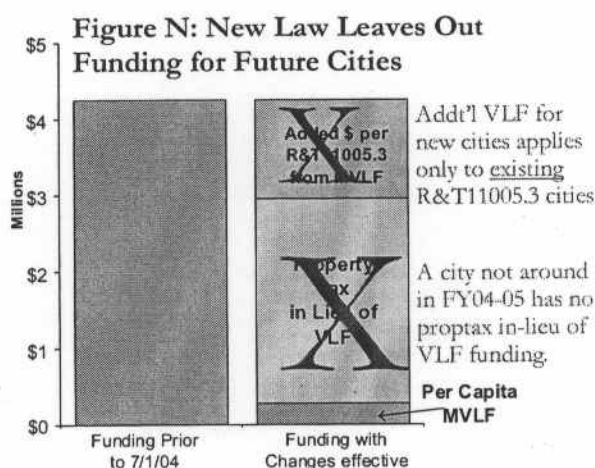
### No Property Tax in Lieu of VLF for Future Cities

The new law specifies that County Auditors calculate and transfer to each city and county an allocation of property tax in lieu of VLF (the "VLF Adjustment Amount") based on each agency's FY04-05 revenues. Specifically, the property tax in lieu of VLF is the difference between:

- what the agency would have received in FY04-05 under the prior law, including a 2% VLF rate and prior allocations, and
- what the agency actually receives from the MVLF account given the 0.65% rate and new allocations.

In subsequent years, each agency's property tax in lieu of VLF will be increased from the prior year amount in proportion to the agency's increase in gross taxable assessed valuation.<sup>13</sup>

A city that is not in existence in FY04-05 has no VLF adjustment amount and the new law provides no procedure to establish one.



mc

<sup>12</sup> Revenue and Taxation Code Sec 11005(b)

<sup>13</sup> With the notable exception regarding annexations described earlier.



November 16, 2004

Katherine Gifford  
County of Riverside  
4080 Lemon Street, 4<sup>th</sup> Floor  
Riverside, California 92501

Via E-mail

Subject: First Amendment To Contract For Wildomar Fiscal Analysis and Municipal Service Reviews (revised)

Dear Ms. Gifford:

The purpose of this letter is to detail a scope of work and budget for additional services under our current contract with the County. The purpose of the contract is to perform an initial fiscal analysis of governance options and a municipal service review for the Wildomar community.

### **Scope of Work**

**Task 1b: *Meetings and Public Workshops***

Delete one meeting from the original scope of work.

**Task 4: *Update Fiscal Model For Changes To Vehicle License Fee Subvention***

The State Legislature amended the vehicle license fee (VLF) subvention statute this past summer following the delivery of the first administrative draft report for the Wildomar project. These amendments significantly affected the estimates of VLF revenue contained in that draft report. This task includes researching the effects of the new law, incorporating those changes into the fiscal model, revising report tables, and re-drafting report sections to explain these changes. This task also includes some minor changes that arose after delivery of the first administrative draft to the tax increment and educational revenue augmentation fund estimates in the fiscal model.

**Task 5: *Response To Comments on Public Draft***

Following publication of the public draft County staff are responsible for receiving and indexing comments and forwarding to us for comment. We will respond to submitted comments in a separate document appended to the final draft.

November 8, 2004

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## **Budget**

We will complete the scope of work described above for this amendment study for a lump sum cost of **\$10,000**, including all direct expenses. We will invoice on a task completion basis, adding these tasks to the current invoices we submit to the County for this project.

If the terms of this amendment are acceptable to the County please provide us with written indication of your approval.

We appreciate this opportunity to continue to assist the County, the City of Murrieta, the Riverside County Local Agency Formation Commission, and the Wildomar community with this important community planning effort. We look forward to hearing from you.

Sincerely,

MuniFinancial

A handwritten signature in black ink that reads "Robert D. Spencer". The signature is written in a cursive style with a large, stylized initial "R".

Robert D. Spencer  
Principal Consultant

**Professional Service Agreement Amendment with MuniFinancial for Services Related to the Wildomar Municipal Service and Initial Fiscal Review.**

IN WITNESS WHEREOF, the parties hereto have caused their duly authorized representatives to execute this amendment:

**County of Riverside**

**MuniFinancial**

\_\_\_\_\_  
Chairman, Board of Supervisors

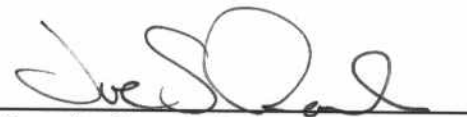
\_\_\_\_\_  
Print Name: Robert D. Spencer  
Title: Principal Consultant

**ATTEST:**

Nancy Romero, Clerk of the Board

By: \_\_\_\_\_  
Deputy

*Approve as to Form:*

  
\_\_\_\_\_  
County Counsel