

Proposition M: National City 1% Sales Tax Repeal - Repeal of Prop D (2006)

Board Recommendation:

SUPPORT

Rationale:

SDCTA opposed Prop D in 2006 because it provided additional revenue to National City's general fund as opposed to being specifically earmarked for a stated need or purpose. Additionally, the City had allowed its expenditures to exceed revenues in the years prior to the passage of Prop D.

Finally, a comparison of National City's expenditures and revenues over time to the average full-service¹ municipality in California reveals that in the years leading up to the sales tax proposal, National City allowed expenditures to increase dramatically. The City claimed that circumstances out of its control caused the budget shortfall, but the same circumstances cited by the City applied to all municipalities, which were able to keep expenditures in line with revenues on average.

Background:

Prop D (2006)²

In June of 2006, National City voters approved a sales tax increase of 1%, bringing the sales tax rate in National City to the current County and State high of 8.75%. The question put to voters read:

“Shall an ordinance be approved imposing a one percent transactions and use tax (a sales tax) for up to 10 years for City services, facilities and programs?”

The measure passed by a margin of 59.01% - 40.99% (2993 “yes” votes to 2079 “no” votes). Additionally, the measure contained an automatic 10-year sunset clause, rendering the additional tax rate non-applicable after October of 2016.

Prior to the successful passage of Prop D, National City attempted to pass the same sales tax increase in November of 2005, minus the sunset clause. The initiative failed by a margin of 56.86% to 43.14% (3417 to 2593 votes).

The sales tax has been estimated to generate between \$7 and \$9 million annually for the City's general fund since its passage in 2006, allowing the City to increase revenues to meet expenditures following a budget shortfall of \$6.7 million in FY 2005-2006.³

¹ In the data set used for this analysis, “Full Service” cities provide Police, Fire, Parks and Libraries.

² County of San Diego. Official Election Results.

³ Attachment to National City ELECTIONS CODE Section 9212. Report to Legislative Body on Effect of Proposed Initiative.

SB566

The proposal of the Prop D sales tax was enabled by 2003's SB566 (Scott), which allows counties and cities in California to seek voter approval of local transactions and use taxes under certain conditions⁴:

- The tax must be imposed at a rate of .25%, or a multiple thereof
- The governing body must approve proposing the tax by a 2/3 majority
- General purpose taxes must be approved by a majority (50% +1) vote
- Specific taxes must be approved by a 2/3 vote
- The maximum combination of Transaction and Use tax rates "in any location may not exceed 2%." (In the case of San Diego, the combination of the TransNet sales tax of .5% and any local jurisdictional tax may not exceed 2%.)

Recent history of municipal sales taxes reveals that SB566 marked a significant paradigm shift in California municipal revenue increases. Prior to 2003, "with few exceptions," local sales tax increases were earmarked for specific purposes and required a 2/3-approval rate from voters. Following SB566, however, municipalities increasingly utilize the general revenue option with its corresponding lower voter approval threshold. To illustrate this trend, consider that 70 general-purpose taxes have been proposed across California since 1995, and that 64 (of which 37 passed) of these increases were proposed after SB566 went into effect.⁵

The Economic Impact of Sales Taxes

For a full presentation of the economic impact of sales taxes, as well as the general analysis framework used to evaluate this measure, see the SDCTA "General Analysis of Sales Taxes."

SDCTA Precedent

SDCTA opposed Prop D in 2006 for two particular reasons:

- 1) National City had allowed its expenditures to exceed its revenues prior to proposing a sales tax increase.
- 2) The revenue increase requested by the City to help offset a budget shortfall of \$6.7 million was designated for the general fund, allowing the additional funds to be spent at the discretion of the City, and not on any particularly mentioned need or service.

⁴ "Local Add-On Sales Taxes: The Rise of Transactions (Sales) and Use Taxes for Cities." The League of California Cities: February 9, 2008.

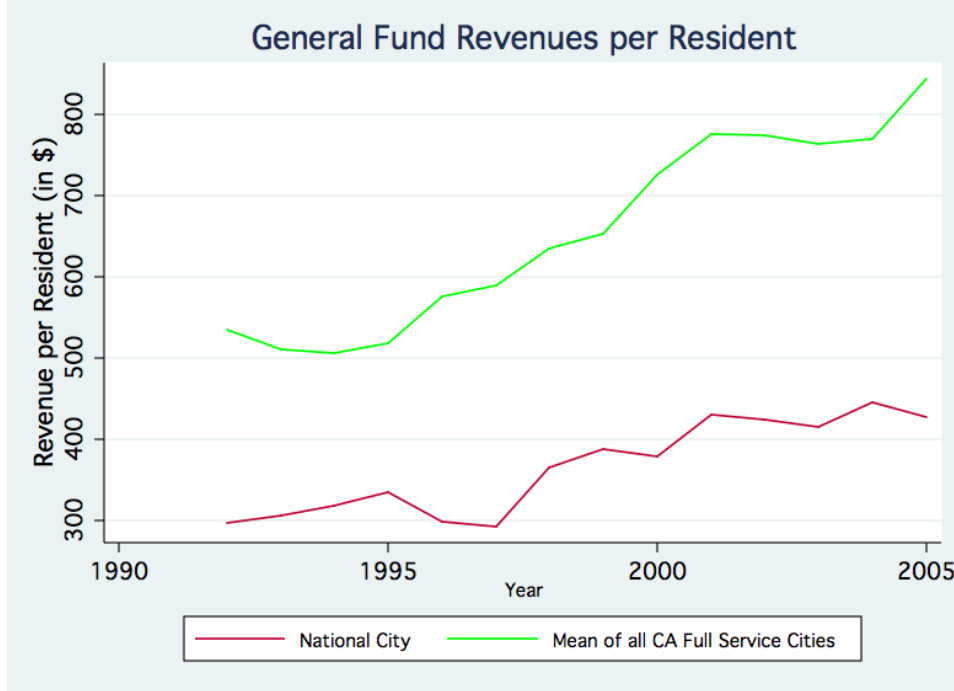
⁵ Ibid.

Municipal Profile: National City

Revenues

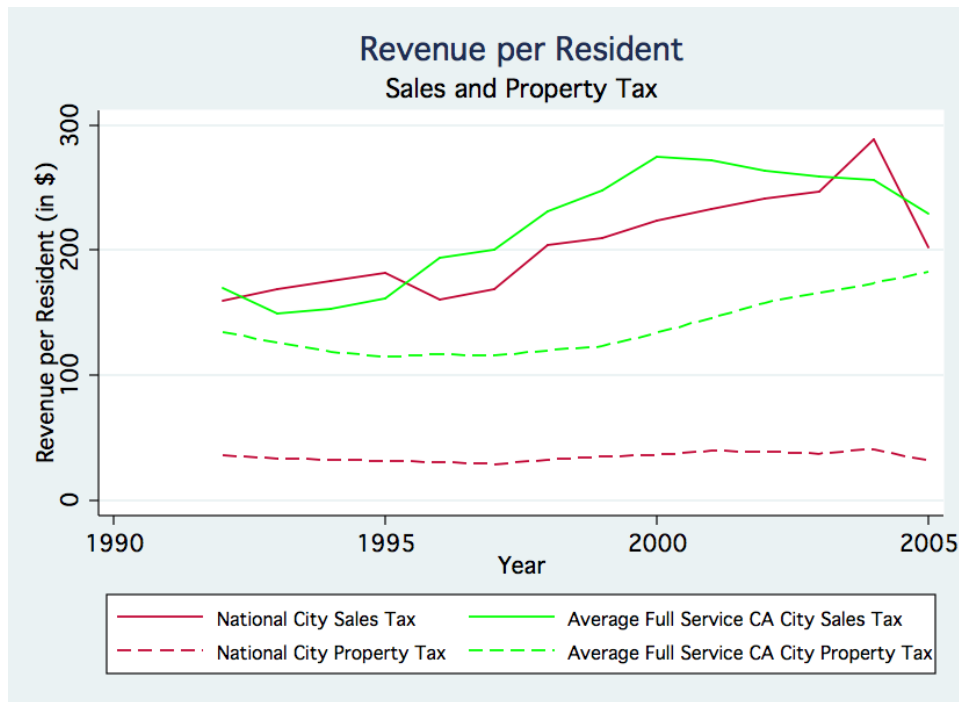
California Finance Department and State Controller Data from 1992 to 2005 reveals several municipal characteristics of National City. Using the average of all full service municipalities throughout the state as a benchmark for comparison and presenting statistics in a *per resident* format, National City consistently obtains less revenue when compared to its full service counterparts throughout the state.

(Figure 1) Data Source: California Department of Finance, California State Controller (All time-series graphs below utilize data from these same sources in addition to municipal annual reports in some cases.)



The source of the revenue shortfall in the National City General Fund can be identified by examining property tax and sales tax revenue over the same period of time. (See Figure 2)

(Figure 2)



As *Figure 2* shows, prior to the passage of Prop D, National City collected a relatively similar amount of sales tax revenue per resident when compared to its full service counterparts throughout the state. However, the City’s receipts from property tax revenues consistently fell far below that of the average full service municipality.

Expenditures

Expenditure data used for this analysis of National City’s General Fund include four categories: Police, Fire, Parks and Libraries. Compared to the average full service California municipality, National City spent less per resident on Police and Fire departments until 2003, when Fire Department expenditures per resident increased above the state average. Police expenditures per resident have increased consistently since 1992, although the trend in National City has almost mirrored that of the state average.

See *Figure 3* for a more inclusive trend in general fund revenues and expenditures.

Municipal Response

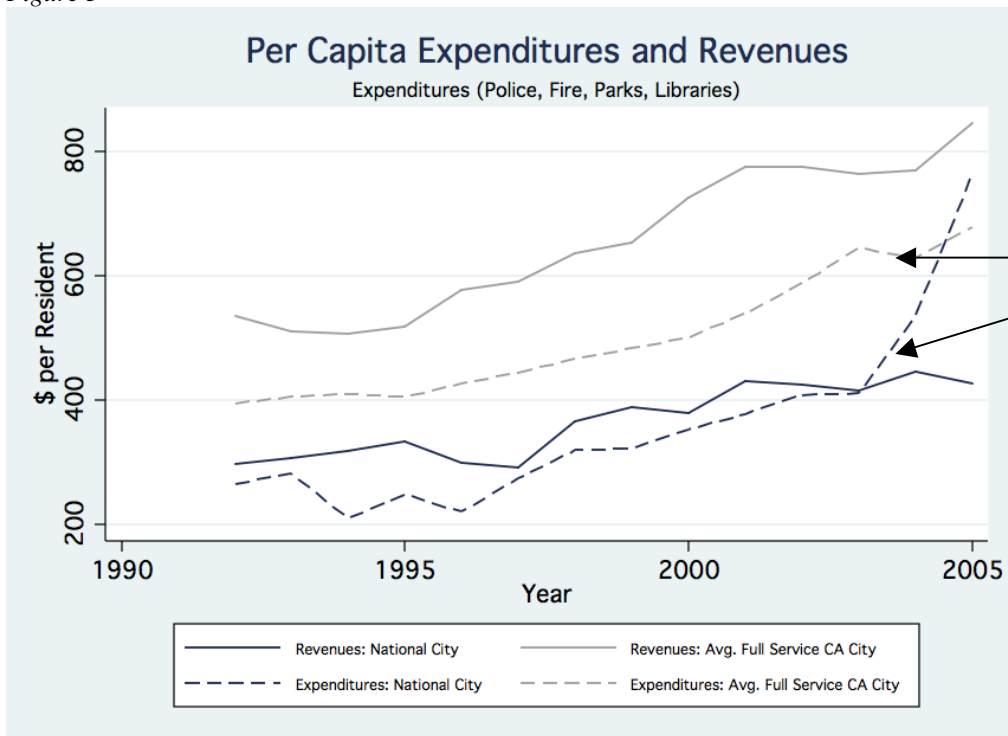
In response to the proposed repeal of Prop D, National City claims it needs the additional revenue obtained from the Prop D sales tax in order to maintain minimum service levels. The City explains its financial struggles as being “beyond the control of the local government.” In particular, National City asserts that “increased take-aways from local governments” in combination with a “\$5 million increase in [National City’s] CalPERS rates” were the driving forces behind the structural budget deficit, requiring the City to obtain additional revenue.⁶

⁶ See Footnote 2.

Further Analysis:

An examination of National City’s expenditures on four general fund categories as well as its General Fund revenues since 1992 compared to the average full service municipality in the state conflicts with the Municipal Response presented above. Using other CA municipalities as a comparison reveals that an expenditure increase, and not a change in revenue, drove the City to seek additional revenue via a sales tax increase.

Figure 3



Time trend comparisons reveal that although National City has had consistently lower revenues when compared to its Full Service counterparts over time, the municipality allowed expenditures to soar in 2003. The circumstances used to justify additional revenues via a sales tax increase applied to other full service municipalities throughout the state as well. These municipalities on average, however, were able to keep expenditures in check relative to revenues.