



STAFF REPORT

AGENDA NO: 8m

MEETING DATE: June 7, 2021

To: Honorable Mayor and City Council

Date: June 7, 2021

From: Lisa K. Goldman, City Manager – (650) 558-7243

Subject: Authorize the Mayor to Send a Letter to the Governor and Chairs of the Senate and Assembly Budget Committees Regarding the Vehicle License Fee Swap Obligation

RECOMMENDATION

Staff recommends the City Council authorize the Mayor to send the attached letter to the Governor and Chairs of the Senate and Assembly Budget Committees regarding the Vehicle License Fee (VLF) Swap obligation.

BACKGROUND

The VLF “Swap” was an integral part of the 2004 Budget compromise (See SB 1096). Under the terms of that compromise, the State permanently reduced annual VLF revenues that were a significant funding source for counties and cities, by 67.5%, and also shifted \$1.3 billion more in property taxes away from all counties, cities, and special districts to pay the State’s school funding obligations for two fiscal years. By way of these shifts, the counties and cities gave up significant revenue to address the State’s budget deficit. In exchange, the State guaranteed counties and cities an in-lieu VLF payment (adjusted annually for property tax growth).

DISCUSSION

The VLF Swap legislation identified two sources of funding to pay the State’s in-lieu VLF obligation to counties and cities: (a) Educational Revenue Augmentation Fund (ERAF) distributions to non-basic aid schools; and (b) property tax revenues of non-basic aid schools. Non-basic aid schools do not suffer any financial loss since they are backfilled by the State. The Legislature did not anticipate the funding sources would be insufficient to fulfill the State’s in-lieu VLF obligation. In recent years, however, VLF revenue shortfalls have occurred and will continue to occur in counties around the state, including San Mateo County.

Historically, the State has made counties and cities whole by reimbursing in-lieu VLF revenue shortfalls 14 months after the fiscal year in which the shortfall occurred through special appropriations in the State budget. This delay causes significant cash flow issues for impacted counties and cities.

The current statutes do not provide a mechanism to fully reimburse counties and cities the entire State in-lieu VLF obligation when there are insufficient funds from ERAF and property taxes of non-basic aid schools. In other words, there is no procedure for the State's obligation to be fulfilled in a predictable manner when revenue shortfalls occur. Hence, the law needs to be amended to fix this unanticipated consequence.

San Mateo County is supporting a legislative proposal to solve this problem by providing a statutory mechanism for reimbursement to enable the State and counties and cities to manage VLF shortfalls. Under this proposal, which the County has asked all of the cities to support, (a) counties are to submit claims for insufficient in-lieu VLF revenues for the next fiscal year and adjustments for 3 prior fiscal years and (b) the State is provided with advance notice of one year before any reimbursement is due. The proposed solution enables the State and counties and cities to manage in-lieu VLF revenues and would create a subvention mechanism to cover any funding shortfalls.

This proposed amendment to the VLF Swap statute fulfills the State's promise from 2004 in a predictable and stable manner. Without this proposed mechanism to fund insufficient revenues in the current fiscal year, counties and cities will continue to face substantial budget impacts that impair public services.

FISCAL IMPACT

There is no fiscal impact from sending this letter. However, the impact of the VLF shortfall on the City's budget is significant. In FY 2020-21, the City should have received approximately \$4.1 million in VLF. Instead, the City will receive less than \$2.4 million this fiscal year. Another sizeable shortfall is anticipated in FY 2021-22 if this problem is not resolved.

Exhibit:

- Draft Letter