

Proposition J: El Cajon ½ cent (.50%) Sales Tax Increase

**Board Recommendation:**

**OPPOSE**

**Rationale:**

The City of El Cajon has experienced recent cyclical declines in revenue sources such as sales taxes, but its expenditure growth rate has been the primary cause of a structural General Fund deficit. The City acknowledges that increased costs associated with the provision of pension benefits represent the most significant determinant of increased costs, yet in its appeal to voters for additional revenues, maintains “all costs are out of the City’s control.”<sup>1</sup> Furthermore, the City alludes to an upcoming scenario where necessary public safety cuts may mean “the difference between life and death” for residents if the proposed sales tax does not pass.

The City’s revenue stream matches up to its counterparts throughout the County and the impact of ERAF State Takeaways to El Cajon has been relatively small compared to the impact experienced by other local municipalities. El Cajon has taken measures to cut costs in recent years such as hiring freezes, contracting out of select services and department consolidation. However, the City makes no mention of any attempts to deal with the main contributor of its rising costs: retirement benefits with employee contribution funded entirely by the City for all employees.

**Background:**

The City of El Cajon projects a structural budget deficit of approximately \$4 million<sup>2</sup>, and in an effort to avoid using reserve funds to fund the deficit, has proposed a ½ cent sales tax increase. Should the proposed measure receive voter approval, the sales tax rate in El Cajon will increase from its current 8.25% rate to 8.75%. Currently, the City has a ½ cent sales tax increase in effect, Prop O (2004). Prop O provided funding for public safety facilities only, therefore earmarking the funds generated by the measure for a specific purpose. This tax was opposed by SDCTA due a perceived lack of adequate preparation on the part of the City in determining whether or not funds generated by the tax increase would deliver the promised projects to voters. Additionally, the City had no plan to address its deferred maintenance needs at the time. Prop O contains a 10-year sunset provision, and as a result, the potential 8.75% sales tax rate would decrease to 8.25% after November of 2014.

The ballot proposition put to voters will read:

"To prevent further cuts and preserve funding for general city services, including maintaining firefighters and police officers for adequate emergency response, reducing crime and criminal gang/drug activity, maintaining city streets/parks, and preserving

<sup>1</sup> City of El Cajon PowerPoint presentation: “Sales Tax Measure 2008.”

<sup>2</sup> The amount listed in the City’s FY0708 “Five Year Business Plan “is \$3,811,913, although a greater amount has been listed since.

youth/after-school programs; shall the City of El Cajon adopt an ordinance enacting a one-half cent transactions and use (sales) tax, automatically expiring in twenty years, with independent oversight, mandatory audits and all money staying local to preserve El Cajon city services?"

### 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 conditions<sup>3</sup>:

- 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.<sup>4</sup>

### The Economic Impact of Sales Taxes

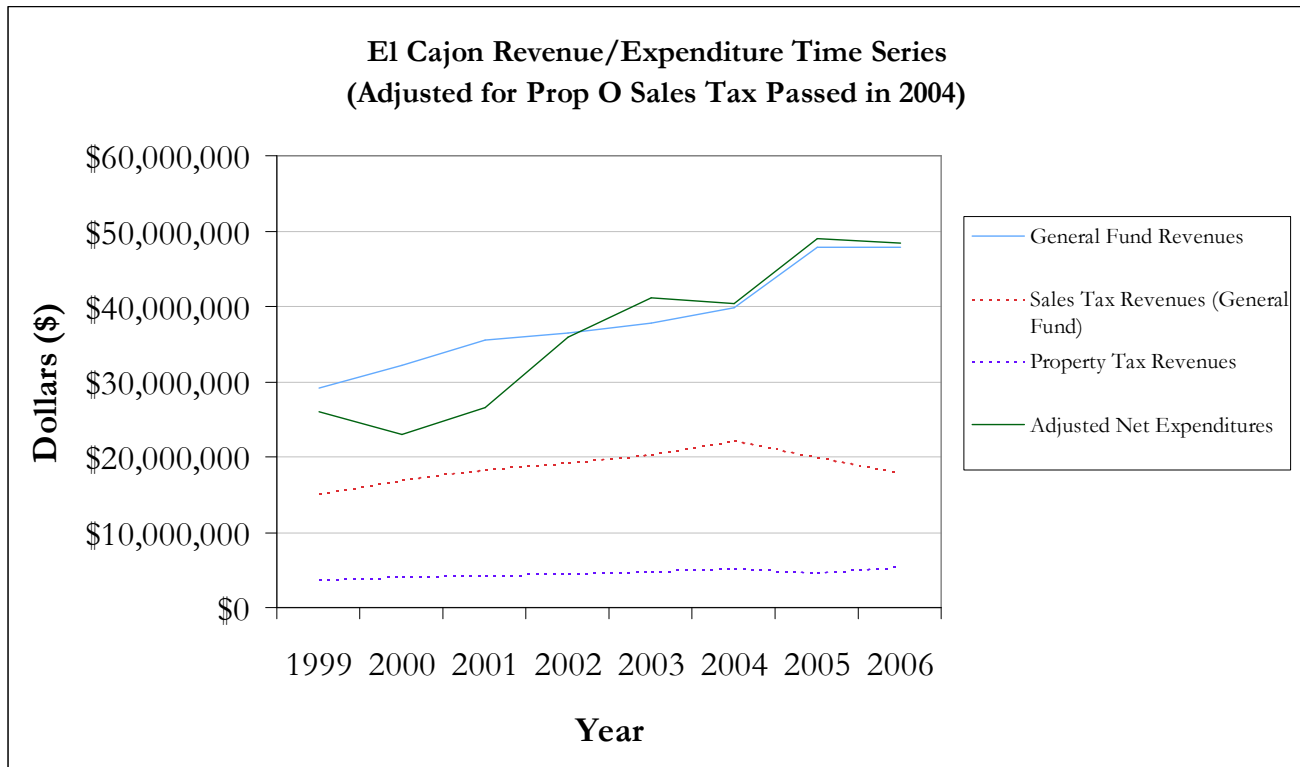
For a full presentation of the economic impact of sales taxes, see the SDCTA "General Analysis of Sales Taxes." Economic theory conclusively shows that sales taxes are the most distortionary to markets relative to other forms of taxation.

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<sup>3</sup> "Local Add-On Sales Taxes: The Rise of Transactions (Sales) and Use Taxes for Cities." The League of California Cities: February 9, 2008.

<sup>4</sup> Ibid.

**Municipal Profile:<sup>5</sup>**



**El Cajon General Fund Revenues and Prop O Adjusted Expenditure: 1999 - 2006**

Dollars (\$)	1999	2000	2001	2002	2003	2004	2005	2006
<b>General Fund Revenues</b>	\$29,203,782	\$32,146,876	\$35,592,507	\$36,376,833	\$37,771,315	\$39,801,000	\$47,858,610	\$47,892,138
Sales Tax Revenues	\$15,095,326	\$16,945,984	\$18,366,557	\$19,262,471	\$20,390,818	\$22,231,603	\$20,021,820	\$17,886,642
Property Tax Revenues	\$3,741,629	\$4,025,194	\$4,286,909	\$4,476,366	\$4,802,861	\$5,179,417	\$4,706,705	\$5,459,432
<b>Net Expenditures</b>	\$26,065,932	\$22,902,275	\$26,449,429	\$35,802,467	\$41,083,765	\$40,378,154	\$49,017,738	\$48,422,857
% Changes from Previous Year								
<b>General Fund Revenues</b>	0.83%	10.08%	10.72%	2.20%	3.83%	5.37%	20.24%	0.07%
Sales Tax Revenues	6.98%	12.26%	8.38%	4.88%	5.86%	9.03%	-9.94%	-10.66%
Property Tax Revenues	3.83%	7.58%	6.50%	4.42%	7.29%	7.84%	-9.13%	15.99%
<b>Net Expenditures</b>		-12.14%	15.49%	35.36%	14.75%	-1.72%	21.40%	-1.21%

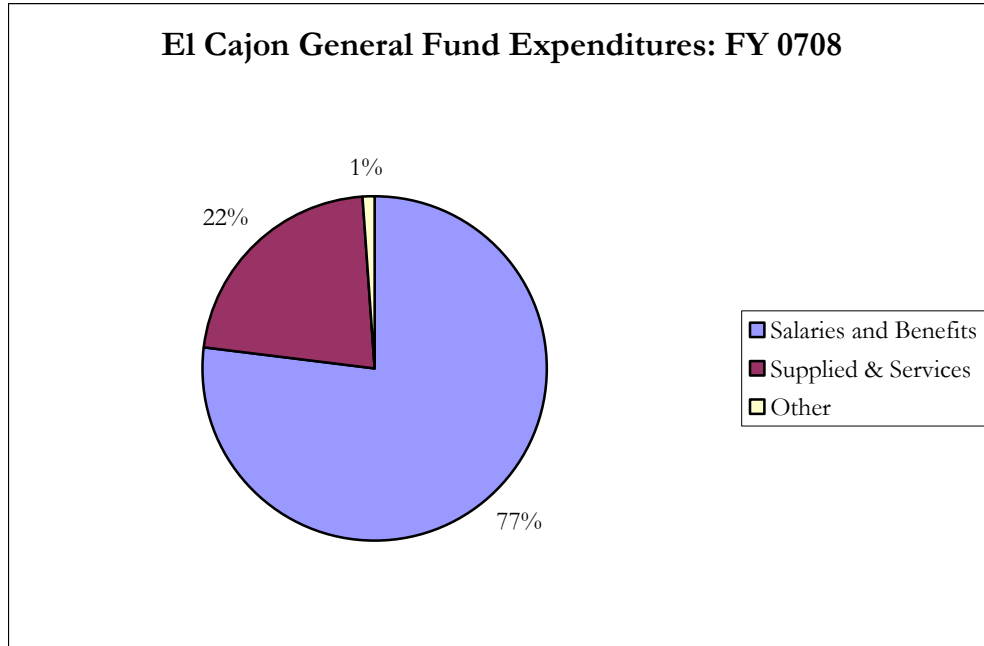
Examining El Cajon’s General Fund expenditures and revenues reveals a relatively steep increase in expenditures from beginning in 2003 and extending to 2005.<sup>6</sup> The City explains this increase as resulting from “retirement rate increases, workers compensation and other insurance cost increases and Medicare and MediCal rates not paying adequate

<sup>5</sup> All municipal time series data throughout this document from California State Controller: *Cities Annual Reports* and the California Department of Finance. Two data errors were found and corrected by SDCTA after receiving a response from the City of El Cajon.

<sup>6</sup> Note that due to accounting allocations in the *Cities Annual Report* issued by the State Controller, revenues generated by the Prop O sales tax are noted as “Functional Revenues,” and therefore artificially reduce the value of “Net Expenditures.” To adjust for this accounting procedure, SDCTA adds the City’s estimated annual Prop O revenue (\$8.5 million) to the value of “Net Expenditures.” A statistical table detailing this adjustment is provided in the appendix of this document.

fees for paramedic ambulance services...*At the same time, the City implemented greater benefit enhancement costs*” (emphasis added).<sup>7</sup>

*Municipal Budget:*



As the chart above shows, the City spends the vast majority of its General Fund revenue (77% in FY 0708) on employee salaries and benefits. In other budget documents released by the City, a more detailed discussion of rising pension costs is provided. The City mentions that the General Fund deficit is brought on by “spiked pension benefit costs and rising insurance costs.” Furthermore, from FY 0001 to FY 0506, the City’s pension costs increased from \$2 million (5% of the General Fund budget) to \$11.7 million (24% of the General Fund budget).<sup>8</sup> For FY 0809, pension costs amount to \$8,930,227 (16.89% of the General Fund budget).

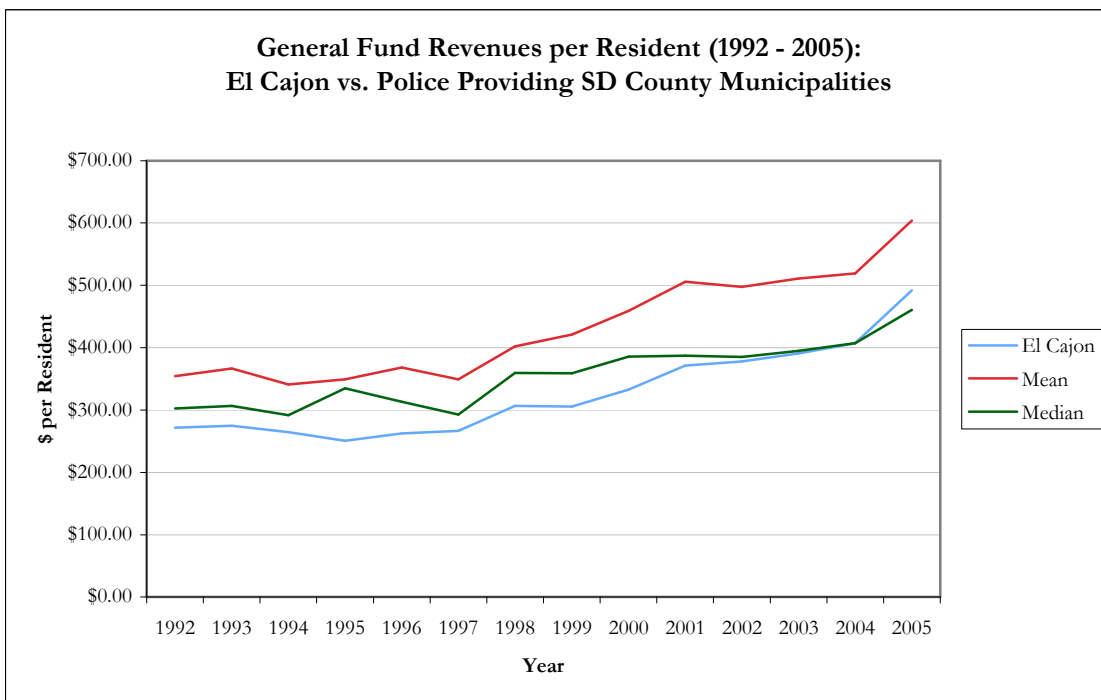
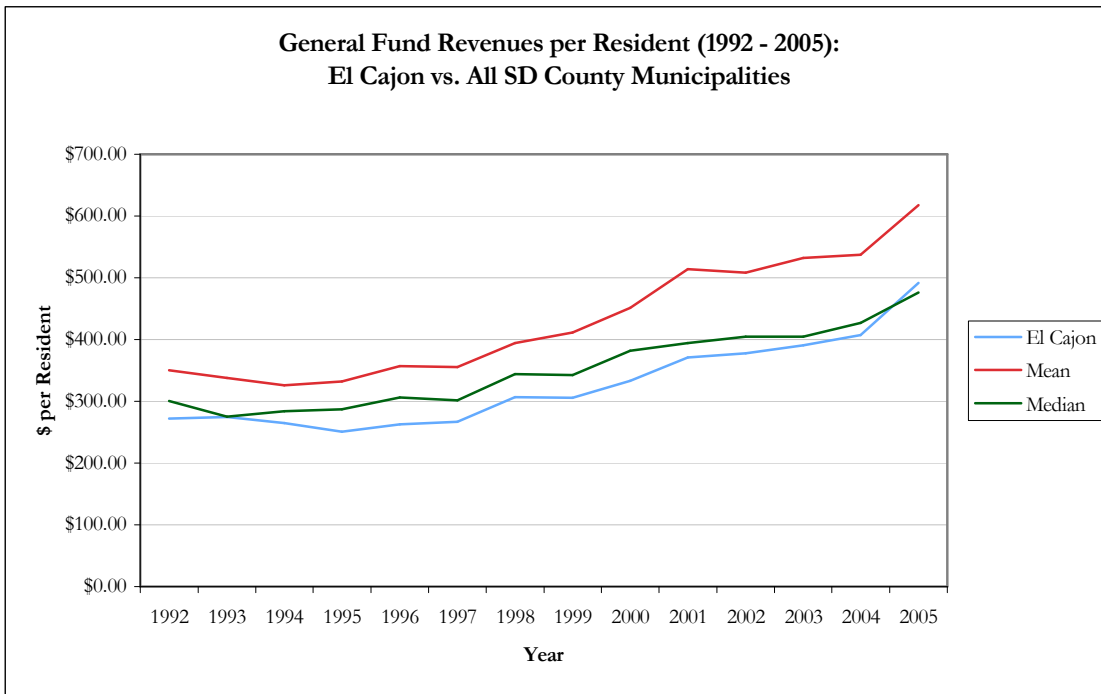
*Pension Benefits*

El Cajon public safety employees receive PERS 3% @ 50, and non-public safety employees receive 3% @ 60. The City pays for the entire employee contribution (8% and 9% for public safety). Since the City payment of this contribution is considered part of the Employer Paid Member Contribution (EPMC) when final pension benefits are being considered, employees earn 97.2% of their highest year annual salary. Note the significant increase in expenditures by the City in 2003 and 2005, the years coinciding with increased pension benefits.

<sup>7</sup> City of El Cajon response to SDCTA staff inquiry.

<sup>8</sup> City of El Cajon. “Fiscal Year 2007-08 Preliminary Budget.”

*Municipal Revenue Comparison:*



Examining the time series plots of El Cajon’s General Fund revenues on Page 5 compared with those of other municipalities throughout the County reveals that El Cajon

experienced per capita General Fund revenue slightly below the mean and median until recently. Notice that El Cajon's revenues rose above the median in both comparisons by 2005, and that the relatively large discrepancy between mean and median in the graph of police providing municipalities can be largely attributed to the cities of Carlsbad and Coronado.

This comparison displays that El Cajon's fiscal imbalance is primarily driven by the City's expenditures, as no unique revenue fluctuations have impacted the City. Notice that the first year that the City began experiencing declining sales tax revenue (FY 0405) coincides with a significant increase in General Fund expenditures.

### **Municipal Assertions**

#### *"16 Years of Money Grabs from the State"*

Educational Revenue Augmentation Funds (ERAFs) were created during a State budget deficit in 1992, in which the State "shifted partial financial responsibility for funding education to local government;" cities, counties and special districts in particular. The State directed county auditors to allocate portions of local property tax revenues into ERAFs as a method of helping to fund Proposition 98 educational funding requirements. Since then, Proposition 1A (2004) has been passed to protect California cities from "additional shifts and State takeaways," but required an additional shift (ERAF III) paid over two fiscal years (FY2004/05 and FY2005/06). ERAF III shifts are no longer active, but the original two ERAF shifts remain.<sup>9</sup>

The presentation below reveals that El Cajon has been one of the least affected municipalities in the County by ERAF State takeaways.

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<sup>9</sup> Coleman, Michael. League of California Cities. May, 2007.

<b>San Diego County Municipality ERAF Fiscal Impact: FY0506</b>			
<b>City</b>	<b>Net ERAF Loss Per Resident 0506</b>	<b>General Fund Proportional Impact: FY 0506</b>	<b>Cumulative ERAF + Mitigation (Prop 172 and COPS)</b>
Del Mar	-\$102	5.55%	-\$4,911,897
<b>Coronado</b>	<b>-\$85</b>	<b>6.30%</b>	<b>-\$21,886,632</b>
<b>Carlsbad</b>	<b>-\$76</b>	<b>6.24%</b>	<b>-\$62,995,333</b>
<b>Oceanside</b>	<b>-\$46</b>	<b>9.57%</b>	<b>-\$72,117,930</b>
<b>San Diego</b>	<b>-\$43</b>		<b>-\$498,793,198</b>
Solana Beach	-\$43	5.26%	-\$5,280,280
Vista	-\$31	7.12%	-\$26,405,193
Poway	-\$29	4.82%	-\$11,589,505
<b>La Mesa</b>	<b>-\$28</b>	<b>6.16%</b>	<b>-\$13,411,551</b>
<b>Chula Vista</b>	<b>-\$28</b>	<b>7.03%</b>	<b>-\$52,236,219</b>
Encinitas	-\$28	3.96%	-\$10,216,549
<b>Escondido</b>	<b>-\$27</b>	<b>5.90%</b>	<b>-\$30,944,374</b>
<b>El Cajon</b>	<b>-\$25</b>	<b>5.07%</b>	<b>-\$19,509,394</b>
Imperial Beach	-\$25	8.89%	-\$7,117,708
Santee	-\$24	5.57%	-\$10,944,314
Lemon Grove	-\$21	5.66%	-\$4,620,135
<b>National City</b>	<b>-\$20</b>	<b>4.49%</b>	<b>-\$9,938,810</b>
San Marcos	-\$20	3.65%	-\$10,407,331

Cities in **BOLD** represent SD County cities responsible for police provision, and are included in relevant comparative analyses.

### *Uncontrollable Costs*

City of El Cajon’s justifications for additional revenues:

- Rising costs such as fuel, electricity, healthcare costs and insurance
- Declining property tax and sales tax revenue (2 largest revenue streams)
- Level of service “highest and most expensive it has ever been.”

While the City faces operating costs that are a function of variable inputs such as fuel and energy prices, the increased costs associated with the increased pension benefits discussed earlier do not appear as part of the City’s explanation. This directly conflicts with the budgetary documents presented by the City, which attribute pension costs and insurance as the primary cause of the structural budget deficit.

The City’s sales tax revenues have been in decline since 2004. The City’s assertion that a ½ cent sales tax increase will yield an equivalent amount of revenue to the increase already in place directly conflicts with economic theory. A sales tax increase from 8.25% to 8.75% will surely be met with consumer avoidance to some extent (a decrease in the quantity of goods subject to the tax that will be purchased relative to the amount that



would be purchased without it); meaning that the revenues obtained by the City by applying an additional market distorting sales tax may increase, but certainly at a decreasing rate as a function of the sales tax rate.

Using El Cajon’s Police Department as a snapshot examination of the City’s claims of highest and most expensive service provision reveals that this claim has some validity. Note, however, that while the provision of police protection in the form of officers has not increased since 2001, the cost associated with the provision of police protection has increased, partly due to the addition of non-sworn positions.<sup>10</sup>

<b>El Cajon Police Expenditure and Staffing Data</b>							
<b>year</b>	<b>pop</b>	<b>Net Police Expenditures</b>	<b>Police Net Expenditures per Resident</b>	<b>Police Officers</b>	<b>Total Police Employees (Including Officers)</b>	<b>% Officers</b>	<b>Net Police Expenditure % Change</b>
1992	89738	\$11,940,551	\$133.06	133	216	61.57%	
1993	90249	\$12,813,815	\$141.98	135	216	62.50%	7.31%
1994	90525	\$11,797,302	\$130.32	122	192	63.54%	-7.93%
1995	91176	\$10,508,792	\$115.26	129	200	64.50%	-10.92%
1996	91794	\$11,220,563	\$122.24	130	197	65.99%	6.77%
1997	92787	\$10,640,241	\$114.67	138	202	68.32%	-5.17%
1998	94524	\$12,148,836	\$128.53	139	217	64.06%	14.18%
1999	95636	\$16,419,827	\$171.69	137	210	65.24%	35.16%
2000	96627	\$14,915,014	\$154.36	139	212	65.57%	-9.16%
2001	95891	\$16,077,762	\$167.67	146	217	67.28%	7.80%
2002	96194	\$18,357,386	\$190.84	146	217	67.28%	14.18%
2003	96664	\$18,634,384	\$192.77	146	217	67.28%	1.51%
2004	97643	\$21,882,694	\$224.11	146	217	67.28%	17.43%
2005	97331	\$22,547,432	\$231.66	146	222.5	65.62%	3.04%

\*Note that SDCTA located a data error regarding the number of officers and total staffing data for years 2002-2004. Therefore, the values for these 3 years are not confirmed, but held constant by SDCTA. Compromised data values are highlighted.

*Other Municipal “Assertions”*

<sup>10</sup> Unless the City hired additional officers and then eliminated an equal number of positions in the years 2002 – 2004. See explanatory footnote in the data table.



While SDCTA is not aware of publicly financed advocacy efforts in the form of mail pieces like those seen in other municipalities, the City uses rather alarming language in an attempt to convince voters to support the sales tax. In particular, the rhetoric used by the City to make assertions such as the following is troubling:

**“At stake: Essential City Services, Including Public Safety.** When you need life saving emergency care, you need it fast. Minutes can mean the difference between life and death. The City’s ballot measure will ensure that we will be able to maintain the level of staffing in police and fire so that they can respond quickly to your emergencies. *Avoid eliminating more police and fire position, closing a fire station and a recreation center, and eliminating after school programs that keep kids safe and away from drugs and violence.*”<sup>11</sup>

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<sup>11</sup> City of El Cajon. “Protecting El Cajon’s Quality of Life.”



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**Appendix: El Cajon General Fund Revenue and Expenditure Data in Detail (Adjusted for Prop O, 2004, Sales Tax)**

Dollars (\$)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
General Fund Revenues	24370184	24767018	23938971	22855896	24092824	24735753	28964555	29203782	32146876	35592507	36376833	37771315	39801000	47858610	47892138
Sales Tax Revenues	12561969	12544247	12398347	12067028	12859663	13171964	14109815	15095326	16945984	18366557	19262471	20390818	22231603	20021820	17886642
Property Tax Revenues	4510807	4288868	3632910	3627343	3543329	3526752	3603753	3741629	4025194	4286909	4476366	4802861	5179417	4706705	5459432
Net Expenditures								26065932	22902275	26449429	35802467	41083765	40378154	49017738	48422857
% Changes															
General Fund Revenues		1.63%	-3.34%	-4.52%	5.41%	2.67%	17.10%	0.83%	10.08%	10.72%	2.20%	3.83%	5.37%	20.24%	0.07%
Sales Tax Revenues		-0.14%	-1.16%	-2.67%	6.57%	2.43%	7.12%	6.98%	12.26%	8.38%	4.88%	5.86%	9.03%	-9.94%	-10.66%
Property Tax Revenues		-4.92%	-15.29%	-0.15%	-2.32%	-0.47%	2.18%	3.83%	7.58%	6.50%	4.42%	7.29%	7.84%	-9.13%	15.99%
Net Expenditures									-12.14%	15.49%	35.36%	14.75%	-1.72%	21.40%	-1.21%

year	Police			Fire			Parks and Recreation		
	Net Expenditures	Change	% Change	Net Expenditures	Change	% Change	Net Expenditures	Change	% Change
1992	11940551			5321952			2649324		
1993	12813815	873264	7.31%	5118414	-203538	-3.82%	2214496	-434828	-16.41%
1994	11797302	-1016513	-7.93%	4968784	-149630	-2.92%	2189013	-25483	-1.15%
1995	10508792	-1288510	-10.92%	5053215	84431	1.70%	2020774	-168239	-7.69%
1996	11220563	711771	6.77%	4629949	-423266	-8.38%	2972542	951768	47.10%
1997	10640241	-580322	-5.17%	3815975	-813974	-17.58%	2794769	-177773	-5.98%
1998	12148836	1508595	14.18%	4713736	897761	23.53%	2863991	69222	2.48%
1999	16419827	4270991	35.16%	4452830	-260906	-5.54%	3186408	322417	11.26%
2000	14915014	-1504813	-9.16%	4594042	141212	3.17%	3531875	345467	10.84%
2001	16077762	1162748	7.80%	5038619	444577	9.68%	3511535	-20340	-0.58%
2002	18357386	2279624	14.18%	5481922	443303	8.80%	3993261	481726	13.72%
2003	18634384	276998	1.51%	5454366	-27556	-0.50%	3686676	-306585	-7.68%
2004	21882694	3248310	17.43%	5837654	383288	7.03%	4544877	858201	23.28%
2005	22547432	664738	3.04%	7422750	1585096	27.15%	4845819	300942	6.62%
2006	17423215	-5124217	-22.73%	3249706	-4173044	-56.22%	4629341	-216478	-4.47%
2006*	Net Expenditure Adjusted for Prop O Revenue for Police and Fire: \$29,172,921								

\* Reflects SDCTA's removal of the Prop O sales tax impact to the Net Expenditure statistic. (2006 FR - 2005 FR) is added to 2006 Net Expenditure.