

Prop L: La Mesa $\frac{3}{4}$ cent (.75%) Sales Tax Increase

Board Recommendation:

OPPOSE

Rationale:

The City of La Mesa's need for a revenue increase is clearly self-imposed, as the City has allowed expenditures to exceed revenues annually since 2001.

The City spends approximately 75% of its budget on employee salaries and benefits, including a pension program in which the City fully finances the employee contribution, which is then considered as part of the base determination of pension benefits. Furthermore, these retirement benefits apply not only to public safety employees, but also to general employees that earn Social Security benefits in addition to a pension. While the PERS retirement plan offered to La Mesa public safety employees is consistent with public safety plans throughout the County, the extension of entirely publicly funded employee contributions to general employees is not universally prolific throughout the County. The City maintains that its police officers are the lowest paid in San Diego County, but analysis of the City's provision of police protection since 1992 does not support claims of hampered recruitment and retention efforts.

La Mesa's claim that State takeaways have imposed a fiscal strain on the City's finances is valid, especially the significant impact of ERAF transfers. However, La Mesa has not been affected by these takeaways significantly more or less than other local municipalities. Additionally, these takeaways have been in place since 1992, and do not represent a new fiscal challenge to the City. While the current State budget crisis may impose additional fiscal challenges on the City, the presence of a structural deficit in La Mesa's General Fund has been in place since 2001, a result of the City's inability to reign in expenditures.

Background:

The City of La Mesa proposes an additional $\frac{3}{4}$ cent sales tax, which will increase the current rate of 7.75% to 8.5%. If the other two November sales tax ballot measures (National City and El Cajon) result in no change from the status quo, this increase will give La Mesa the second highest sales tax rate in San Diego County, and is expected to generate \$7.2 million annually for the City, with a 20 year sunset clause.

The proposal being considered by the La Mesa City Council on July 22 to be placed on the ballot will read:

“La Mesa Vital City Services Measure. To maintain essential City services including natural disaster response/preparedness programs; youth anti-gang/anti-drug prevention; retaining quality firefighters/paramedics and police officers; increasing street paving/pothole repair; enhancing trolley station security;

maintaining the senior community center, after school tutoring and recreation programs; and other general services shall the City sales tax be increased by 3/4 of a cent, requiring annual audits, public expenditure reports, with 20 year expiration?”

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 conditions¹:

- 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.²

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.

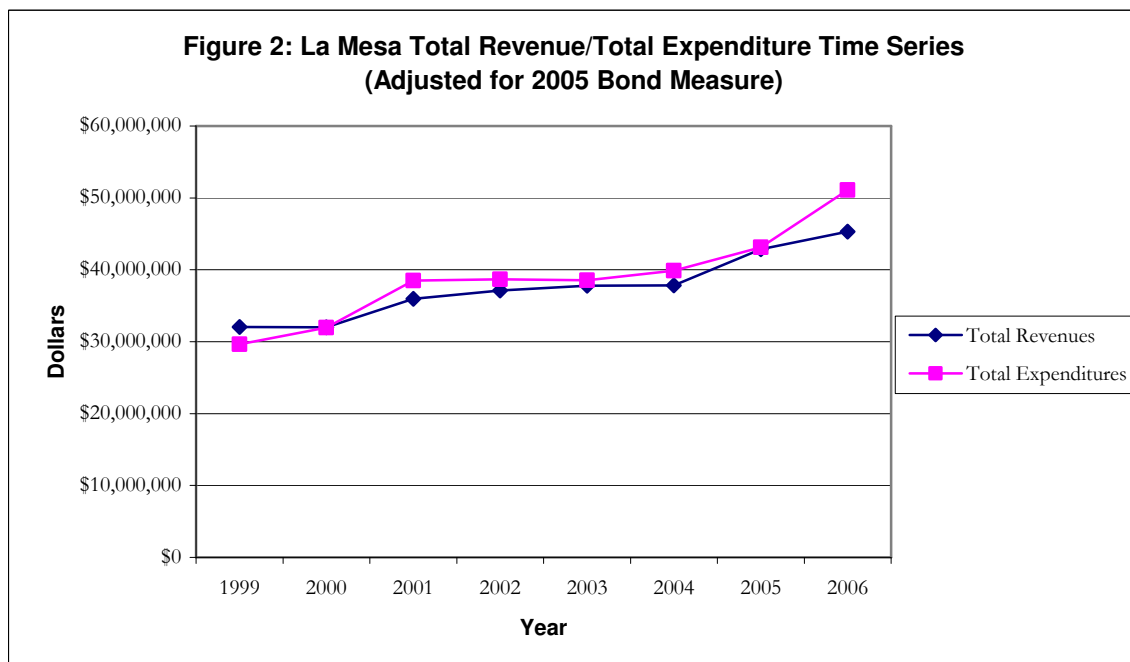
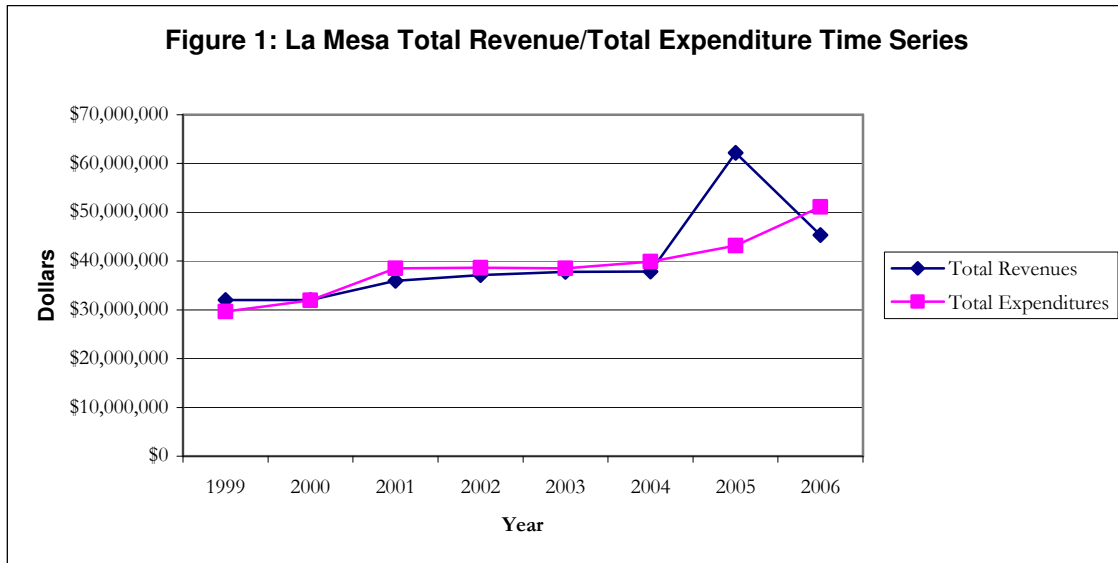
Municipal Profile:

La Mesa is responsible for delivering three major services from its General Fund to its approximately 56,000 residents: Police and Fire protection, and Parks and Recreation. Examining La Mesa’s total expenditures and revenues since 1992 reveals that the City has consistently spent more than it has taken in. *Figure 1* below displays the trend in total revenues and expenditures for La Mesa, while *Figure 2* displays the same trend, but

¹ “Local Add-On Sales Taxes: The Rise of Transactions (Sales) and Use Taxes for Cities.” The League of California Cities: February 9, 2008.

² Ibid.

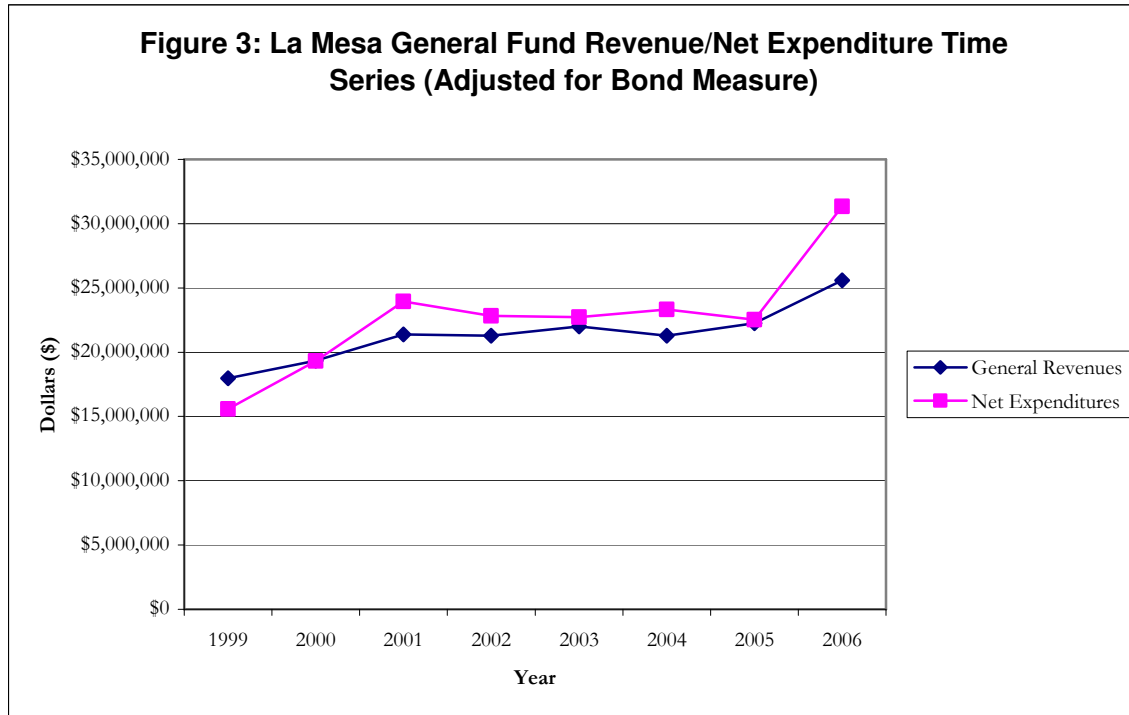
accounts for the Police and Fire facilities bond (Prop D, 2004), which creates an outlier for 2005 (FY0405) in *Figure 1*.^{3,4} Accounting for the bond measure as in *Figure 2* shows that La Mesa’s total expenditures have exceeded its total revenues in every year since 2001.



³ The proceeds from the bond sale of \$20,500,000 authorized by voters in Prop D is represented as \$19,343,425 in the State Controller’s *Cities Annual Report*. SDCTA adjusts *Figures 2 and 4* to account for this anomaly by adding this amount back into the “Net Expenditures” category.

⁴ All data in *Figures 1-3* derived from: *Cities Annual Report*. California State Controller, FY9899 – FY0506.

Furthermore, isolating General Fund expenditures⁵ and revenues depicts an analogous trend, indicating a structural budget deficit, as shown in *Figure 3*.



Examining the trends of La Mesa’s expenditures and revenues over time convincingly shows that the City has, in general, allowed expenditure growth to significantly exceed that of revenue. Referring to *Table 1*, General Fund revenues have grown at an average rate of 4.64% for the past 14 years. Since 1999 (the year at which annual Net Expenditure data was readily available to SDCTA), the average annual rate of growth slowed to 3.95%. In comparison, however, Net Expenditures averaged an average annual growth rate of 11.59%. (Note the 39.11% increase in expenditures from 2005 to 2006.)

	Average Annual % Change (1992 - 2006)	Average Annual % Change (1999 - 2006)
Adjusted Net Expenditure*		11.59%
General Fund Revenue	4.64%	3.95%
Sales Tax Revenue	3.45%	1.63%
Property Tax Revenue	3.41%	7.25%

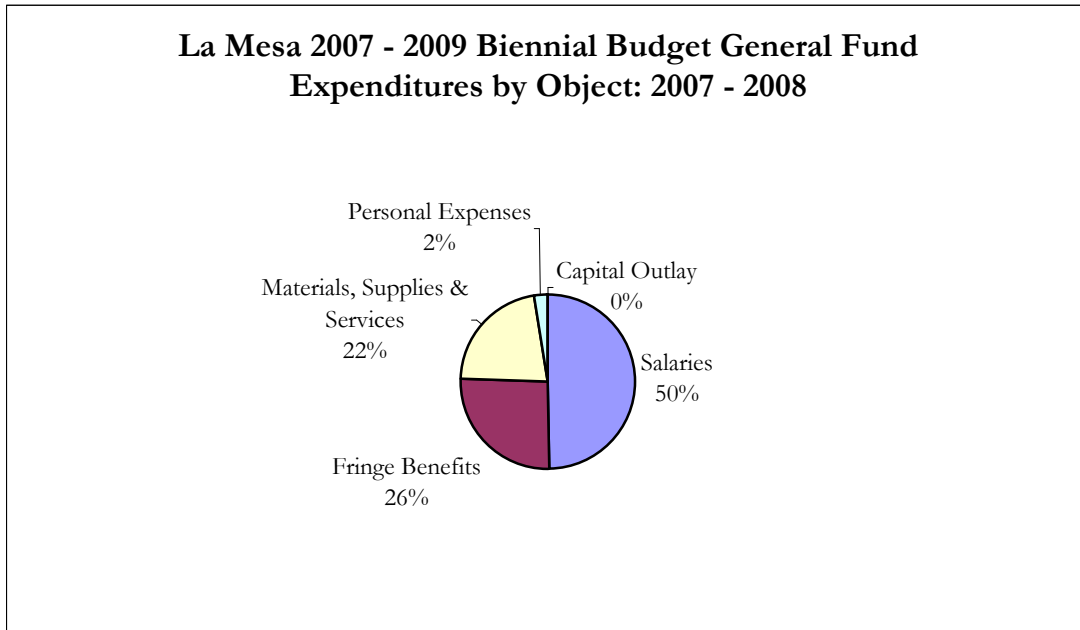
*Expenditures Adjusted to Account for Facilities Bond in FY0405

Municipal Budget:

⁵ Net Expenditures = Total Expenditures – Functional Revenues, as defined by the California State Controller.

⁶ See Appendix 1 for a full data table. Data taken from California Department of Finance and California State Controller.

La Mesa’s overview of the “2007-2009 Biennial Budget” distinctly shows that salaries and benefits account for over 75% of the entire municipal budget, both in FY07/08 and projected FY08/09. Materials, supplies and service represent almost the remainder of all general fund expenditures, totaling approximately 22% in each year. PERS pension benefits account for approximately 15% of the General Fund budget, according to City staff.



Municipal Assertions:

The discussion of the “2007-2009 Biennial Budget” by the La Mesa City Manager, as well as “Important Facts About La Mesa’s Vital City Services Needs,” provide the City’s justification for increasing revenues via a sales tax. The three main justifications given are “years of state money grabs,” declining revenue and increased costs.

As Table 1 shows, the City’s revenues grew at a slightly lower rate over the past 7 years as opposed to the past 14. The clear culprit on the revenue side has been the decline in the average rate of growth of sales tax revenues. Note that revenue growth rates have not declined on average, although they did decrease significantly in 2 recent years.

The City itemizes the fiscal impact of current “State takeaways,” which amount to a total of \$71,000, with three other *possible* takeaways totaling \$536,000. These impacts stem from the recommendations of the state Legislative Analyst prior to the State budget May Revise. Assuming the worst case for La Mesa for the consideration of the legitimacy of the City’s need for revenue, the total loss of State funds listed in the City’s literature could potentially equate to \$607,000, or approximately 2% of projected FY07/08 General

Fund Revenues.^{7, 8} (Note that this figure grows significantly larger when ERAF transfers are included.)

Increased costs represent the City's last explanatory category for financial hardship. Specifically, employee health care costs and retirement costs are mentioned as the two "biggest cost driver[s]." Considering that fringe benefits represent the second largest portion of the General Fund budget (25%) and salaries represent the largest (50%), these expenditures are examined in more detail, along with ERAF transfers, below.

State Takeaways: ERAFs

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.⁹

La Mesa city officials claim that "State Takeaways" have significantly contributed to the City's structural budget deficit, mentioning "over \$16 million since 1991" in conversations with SDCTA staff and in "educational" mail pieces. Table 2 displays the most recent data for which comparative *Cities Annual Report* population data is currently available, FY 2005/06. The net¹⁰ impact of ERAF transfers to each municipality in San Diego County is provided, as well as the net cumulative effects since the 1992 inception of ERAF transfers. Finally, the San Diego County municipalities in bold include those responsible for providing police services, and represent those municipalities used for the analysis of another municipal assertion.

⁷ The definite amount of takeaways listed represents less than 1% of General Fund revenue (.22%) (does not include ERAF).

⁸ A subsequent phone conference between SDCTA and La Mesa City staff shed additional light on the impacts of ERAF transfers as an additional component of "State Takeaways." See the section of this document that deals exclusively with the impacts of ERAF transfers to La Mesa and other municipalities.

⁹ Coleman, Michael. League of California Cities. May, 2007.

¹⁰ The *net impacts* include offsetting State measures considered ERAF "mitigation" by the LAO.

Table 2: San Diego County Municipality ERAF Fiscal Impact: FY0506¹¹			
City	Net ERAF Loss Per Resident FY 0506	General Fund Revenue Proportional Impact: FY 0506	Cumulative ERAF + Mitigation (Prop 172 and COPS)
Del Mar	-\$102	5.55%	-\$4,911,897
Coronado	-\$85	6.30%	-\$21,886,632
Carlsbad	-\$76	6.24%	-\$62,995,333
Oceanside	-\$46	9.57%	-\$72,117,930
San Diego	-\$43		-\$498,793,198
Solana Beach	-\$43	5.26%	-\$5,280,280
Vista	-\$31	7.12%	-\$26,405,193
Poway	-\$29	4.82%	-\$11,589,505
La Mesa	-\$28	6.16%	-\$13,411,551
Chula Vista	-\$28	7.03%	-\$52,236,219
Encinitas	-\$28	3.96%	-\$10,216,549
Escondido	-\$27	5.90%	-\$30,944,374
El Cajon	-\$25	5.07%	-\$19,509,394
Imperial Beach	-\$25	8.89%	-\$7,117,708
Santee	-\$24	5.57%	-\$10,944,314
Lemon Grove	-\$21	5.66%	-\$4,620,135
National City	-\$20	4.49%	-\$9,938,810
San Marcos	-\$20	3.65%	-\$10,407,331

Cities in **BOLD** represent SD County cities responsible for police provision, and are included in the comparative analysis that follows.

Clearly, the impacts displayed in Table 2 reveal that La Mesa has not experienced unique or excessive takeaways relative to other municipalities within the County. La Mesa ranked 9 out of 18 in terms of Net ERAF Losses per Resident in FY 2005/06, and ranked 5 out of 8 in terms of the proportion of its General Fund when compared to police-providing municipalities within San Diego County (the City of San Diego is excluded due to data availability). While Table 2 shows that the impacts to La Mesa from ERAF transfers have been significant, these transfers have been occurring since 1992, and have not affected La Mesa significantly more or less than other local municipalities.

“Cost Drivers”: Municipal Employee Benefits

The pension benefits offered to General and Public Safety employees in La Mesa represent a clear source of significant expenditure. Table 3 describes the retirement benefits packages afforded to employees.

¹¹ California Department of Finance and State Controller.

Table 3: La Mesa Employee Retirement Benefits¹²

Pension	CalPERS 3% @ 60 (3% @ 50 for Public Safety Sworn Officers) Employee Contribution: 8% (9% Public Safety) annual contribution paid entirely by City Variable Employer contribution Single Highest Year Benefit "EPMC ¹³ is reported as income for purposes of calculating compensation at retirement"
Social Security	General Employees only

In addition to Social Security benefits, general employees in La Mesa earn 97.2% of their highest year’s salary annually after retirement due to the incorporation of the entirely publicly funded EPMS (including the “employee” contribution) as a component of compensation into the calculation for determining benefits.

Public Safety Recruitment and Retention Issues

In response to queries regarding the employee retirement benefits above, La Mesa officials assert that their police officers receive the lowest salaries in the County, and furthermore, provided the following 10-year average pay increase data for all City employee categories (Police, Fire, Miscellaneous and Management).

La Mesa 10-Year Average Annual Employee Salary Increase (FY 1998/99 – FY 2007/08):¹⁴

- Police: 4.88%
- Fire: 4.44%
- Miscellaneous: 3.84%
- Management: 3.94%

SDCTA could not obtain a comprehensive data set representing the base salaries and annual increases for all San Diego County municipal employees to evaluate how these increases compared to other local municipalities. As a proxy, SDCTA provides an analysis of the level of relative service provision in an effort to determine the validity of the City’s claim of a recruitment and retention problem.

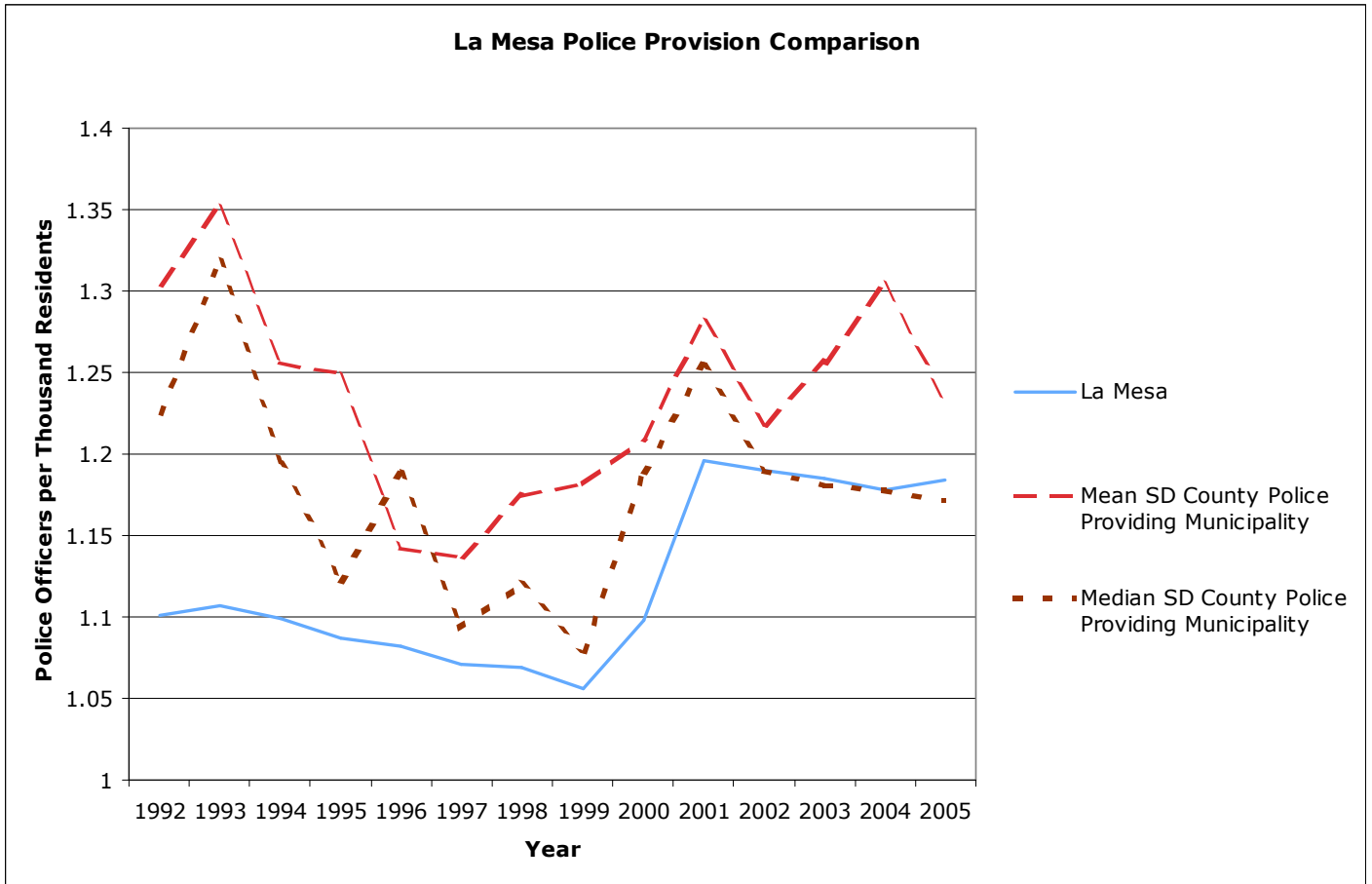
Notice in Figure 4 that La Mesa provided fewer officers per thousand residents than both the mean and median levels in San Diego County until 2002. Additionally, consider that the retirement benefits previously discussed were enacted in 2000. At first glance, the claim that recruitment efforts were hampered prior to the establishment of the retirement benefits seems to be supported by the 2001 increase in per resident police protection in La Mesa. However, staffing data in Table 4 reveals that a population decrease caused the increase in per resident protection, as opposed to increased officer recruitment success resulting from increased benefits.

¹² City of La Mesa “Summary of Fringe Benefits”

¹³ EPMS: Employer Paid Member Contribution

¹⁴ Response to SDCTA inquiry by La Mesa City Manager, Sandy Kerl

Figure 4:¹⁵



¹⁵ Other cities in the County that provide police services include: Carlsbad, Chula Vista, Coronado, El Cajon, Escondido, National City, Oceanside and San Diego.

Year	Police Officers	Total Police Employees (Including Officers)	Population	Police Officers per Thousand Residents	Officers as % of Department
1992	59	77	53605	1.100644	76.62%
1993	61	86	55102	1.107038	70.93%
1994	61	88	55506	1.09898	69.32%
1995	61	84	56124	1.086879	72.62%
1996	61	84	56398	1.081599	72.62%
1997	61	84	56942	1.071265	72.62%
1998	62	86	57994	1.069076	72.09%
1999	62	86	58709	1.056056	72.09%
2000	65	90	59210	1.097787	72.22%
2001	66	92	55203	1.195587	71.74%
2002	66	92	55448	1.190304	71.74%
2003	66	92	55688	1.185175	71.74%
2004	66	94	56049	1.177541	70.21%
2005	66	94	55766	1.183517	70.21%

City “Educational” Materials:

La Mesa has spent a total of \$110,611 in preparing to propose the ¾% sales tax measure. See Table 5 for a detailed description of the funds spent by the City on exploring a sales tax revenue increase. Note that the City planned to expend approximately \$20,000 on a “Community Satisfaction Survey” in the fall, but instead conducted the survey in March to obtain data regarding a potential sales tax.

Item	Cost
March Community Survey	\$20,000
Two Mail Pieces	\$24,984
Consultant Fees (in addition to cost of Survey)	\$23,500
Further Education Materials and Professional Fees	\$42,126.84
Total	\$110,611

On July 21, SDCTA sent a letter to La Mesa Mayor Art Madrid, the La Mesa City Council and the City Manager expressing its staunch opposition to publicly funded advocacy campaigns.

¹⁶ Ibid.

Appendix 1: La Mesa General Fund Revenue and Expenditure Data in Detail

Dollars (\$)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
General Fund Revenue	14170734	14584302	15709264	14656609	15287065	15031945	19060254	17966741	19348163	21394868	21287443	21997255	21288795	22261118	25580859
Sales Tax Revenue	6341137	6829632	6915574	6582399	7489494	7361810	8769942	9483960	10369496	10756994	11561314	12271558	11806960	8963795	9505969
Property Tax Revenue	3127393	3048725	2641865	2655157	2688423	2695111	2791332	2904108	3037765	3249698	3400317	3612948	3896003	4419996	4869727
Net Expenditures								15584974	19321370	23937806	22818182	22737231	23322375	22536306	31350734
% Changes															
General Fund Revenue		2.92%	7.71%	-6.70%	4.30%	-1.67%	26.80%	-5.74%	7.69%	10.58%	-0.50%	3.33%	-3.22%	4.57%	14.91%
Sales Tax Revenue		7.70%	1.26%	-4.82%	13.78%	-1.70%	19.13%	8.14%	9.34%	3.74%	7.48%	6.14%	-3.79%	-24.08%	6.05%
Property Tax Revenue		-2.52%	-13.35%	0.50%	1.25%	0.25%	3.57%	4.04%	4.60%	6.98%	4.63%	6.25%	7.83%	13.45%	10.17%
Net Expenditures								23.97%	23.89%	-4.68%	-0.35%	2.57%	-3.37%	39.11%	

Year	General Fund Revenue			Net (General Fund) 3-Category Expenditures		
	General Fund Revenue	Change	% Change	Unrounded 3-Cat Exp	Change	% Change
1992	14,170,734			11,702,070		
1993	14,584,302	413,568	2.92%	11,758,636	56,566	0.48%
1994	15,709,264	1,124,962	7.71%	12,148,179	389,543	3.31%
1995	14,656,609	-1,052,655	-6.70%	11,891,527	-256,652	-2.11%
1996	15,287,065	630,456	4.30%	11,961,639	70,112	0.59%
1997	15,031,945	-255,120	-1.67%	11,628,275	-333,364	-2.79%
1998	19,060,254	4,028,309	26.80%	12,001,457	373,182	3.21%
1999	17,966,741	-1,093,513	-5.74%	12,227,015	225,558	1.88%
2000	19,348,163	1,381,422	7.69%	12,229,040	2,025	0.02%
2001	21,394,868	2,046,705	10.58%	16,508,589	4,279,549	34.99%
2002	21,287,443	-107,425	-0.50%	16,130,971	-377,618	-2.29%
2003	21,997,255	709,812	3.33%	17,461,883	1,330,912	8.25%
2004	21,288,795	-708,460	-3.22%	16,638,777	-823,106	-4.71%
2005	22,261,118	972,323	4.57%	332,320	16,306,457	98.00%

Police			Fire			Parks and Recreation		
Police Net Exp	Change	% Change	Fire Net Exp	Change	% Change	Park Net Exp	Change	%Change
5,523,856			4,137,600			2,040,614		
5,880,819	356,963	6.46%	3,888,138	-249,462	-6.03%	1,989,679	-50,935	-2.50%
6,337,469	456,650	7.77%	4,025,379	137,241	3.53%	1,785,331	-204,348	-10.27%
6,038,768	-298,701	-4.71%	3,965,281	-60,098	-1.49%	1,887,478	102,147	5.72%
6,072,494	33,726	0.56%	4,316,049	350,768	8.85%	1,573,096	-314,382	-16.66%
5,857,197	-215,297	-3.55%	4,285,976	-30,073	-0.70%	1,485,102	-87,994	-5.59%
6,108,691	251,494	4.29%	4,443,197	157,221	3.67%	1,449,569	-35,533	-2.39%
6,507,444	398,753	6.53%	4,317,179	-126,018	-2.84%	1,402,392	-47,177	-3.25%
6,416,678	-90,766	-1.39%	4,369,293	52,114	1.21%	1,443,069	40,677	2.90%
8,489,947	2,073,269	32.31%	4,641,530	272,237	6.23%	3,377,112	1,934,043	134.02%
8,141,225	-348,722	-4.11%	5,055,394	413,864	8.92%	2,934,352	-442,760	-13.11%
9,371,217	1,229,992	15.11%	5,698,122	642,728	12.71%	2,392,544	-541,808	-18.46%
9,260,451	-110,766	-1.18%	5,496,396	-201,726	-3.54%	1,881,930	-510,614	-21.34%
2,378,500	-1,638,951	-125.68%	486,662	-5,029,734	-91.51%	2,244,158	-362,228	-19.25%