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California's Infrastructure Challenges

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On November 3, 2020, Californians will vote on Proposition 15, also known as the California Schools and Local Communities Funding Act of 2020. The proposition would require commercial and industrial properties to be taxed based on their market value rather than on their purchase price.

Under current law, a property's assessed taxable value is generally set at its purchase price, and annual increases are limited to 2 percent or the rate of inflation (whichever is lower). The assessed value resets to market value only when the property is sold. As a result, for most properties, assessed values are well below market values.

Proposition 15 is often referred to as "split roll" because, if enacted, it would introduce different taxation based on a property's use or "class." The proposition would not change how residential property is taxed in California. Agricultural properties would also be exempt, as would properties owned by individuals or businesses with less than $3 million in total California property holdings.

Another provision of the proposition would eliminate personal property taxes for small businesses (those with 50 or fewer employees). All other businesses would be exempt from taxes on the first $500,000 in value of their personal property.

The proposition would generate an additional $6.5 billion to $11.5 billion in revenue for most years.[1] For context, California collects more than $60 billion in property taxes annually. Revenue from the proposition would be split among K–12 public schools and community colleges (40 percent) and other local government services (60 percent) such as infrastructure, police protection, and hospitals.

The new commercial property tax revenue would also shift California's state and local revenue mix. Since voters passed Proposition 13 and thus limited California's local property taxes, California has increasingly relied on state income tax revenue.[2] Although income taxes have benefits, such as making the overall tax system more progressive, they also make the revenue system more volatile.[3]

To help inform policy debates about Proposition 15, the Urban Institute is making available the following three briefs:

1. **California's State and Local Revenue System.** This brief compares California's revenue system with national trends. We detail how Proposition 13 shifted revenue collection away from local property taxes toward state income taxes and the fiscal consequences of this change.
2. **California's K–12 Education Needs.** This brief compares California's elementary and secondary education system with other states' systems. Although California's funding per pupil has increased in recent years, California's cost of living is higher than many other states', and its large, diverse population of students, including many living in poverty, requires additional resources and more local control of resources.
3. **California's Infrastructure Challenges.** This brief describes California's infrastructure spending and relates how, despite recent infusions of funds, the state still lacks a stable, predictable, adequate revenue source. This creates problems addressing deferred maintenance backlogs, regional inequities, and challenges preparing for climate change.

Each brief helps readers better understand the proposition and how California's finances and government services could change if it passes.

Overview of California's Infrastructure System

Infrastructure refers to a broad array of assets, facilities, and systems that are essential to a healthy and productive society. Examples include highways, roads, bridges, transit, and broadband networks that allow for the movement of people, goods, and ideas. Other infrastructure, such as water treatment facilities, help keep individuals and communities safe and enhance people's quality of life.

Given the COVID-19 pandemic, California's near-term fiscal and economic future is uncertain. But in the longer term, the state will continue to face pressures on its infrastructure including from population growth (especially in previously underserved communities and regions) as well as from extreme heat, drought, poor air quality, sea-level rise, and other threats posed by global climate change.

Like other state and federal infrastructure, California's infrastructure investment requires a stable, predictable, and adequate revenue source. Historically, California's infrastructure spending has been roughly equivalent to the US average for all states, but it has lagged other states in some sectors (such as highways). Its funding challenge is compounded by state limitations on state and local taxes and property-related fees.[4] These findings are discussed in more detail in the next section.

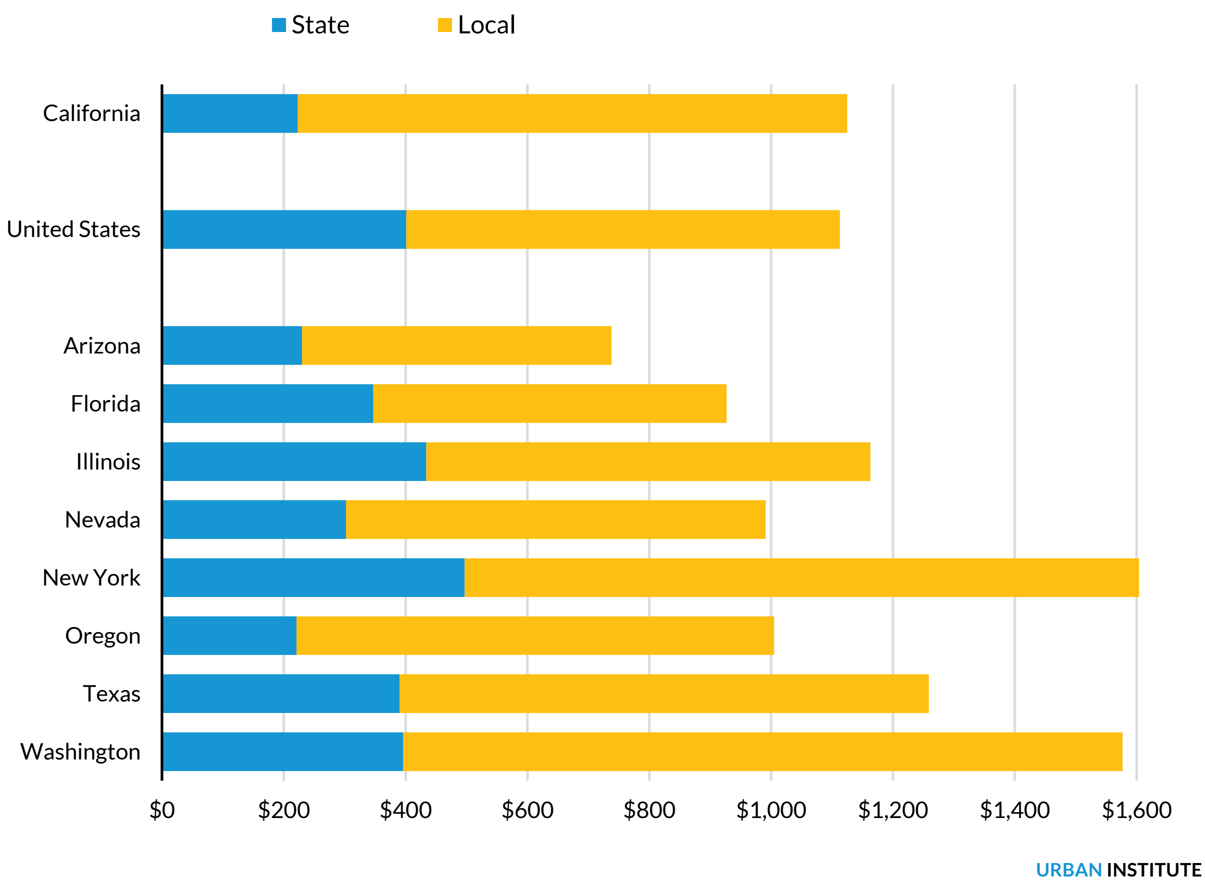
California's Total Infrastructure Spending

Looking at all capital spending (on major physical assets such as roads, bridges, and water treatment facilities as well as schools, courthouses, hospitals, correctional facilities, and other public buildings), California's state and local governments spent $1,124 for every state resident in 2017 (the latest year for which comprehensive data are available).[5] The average US state spent slightly less, at $1,113 per capita.

FIGURE 1

State and Local Capital Outlays by Government Level, 2017

Dollars per capita



Source: US Census Bureau, Annual Survey of State and Local Government Finances.

California differs more dramatically from the average US state in how its capital spending is distributed: roughly 80 percent occurs at the local level (cities, counties, school districts, and special districts); that share averages two-thirds nationally. California's higher local spending (from these governments' own and state-provided funds) is consistent with its overall fiscal decentralization as well as its demographics, geography, land use, and history (e.g., LAO 2019a).

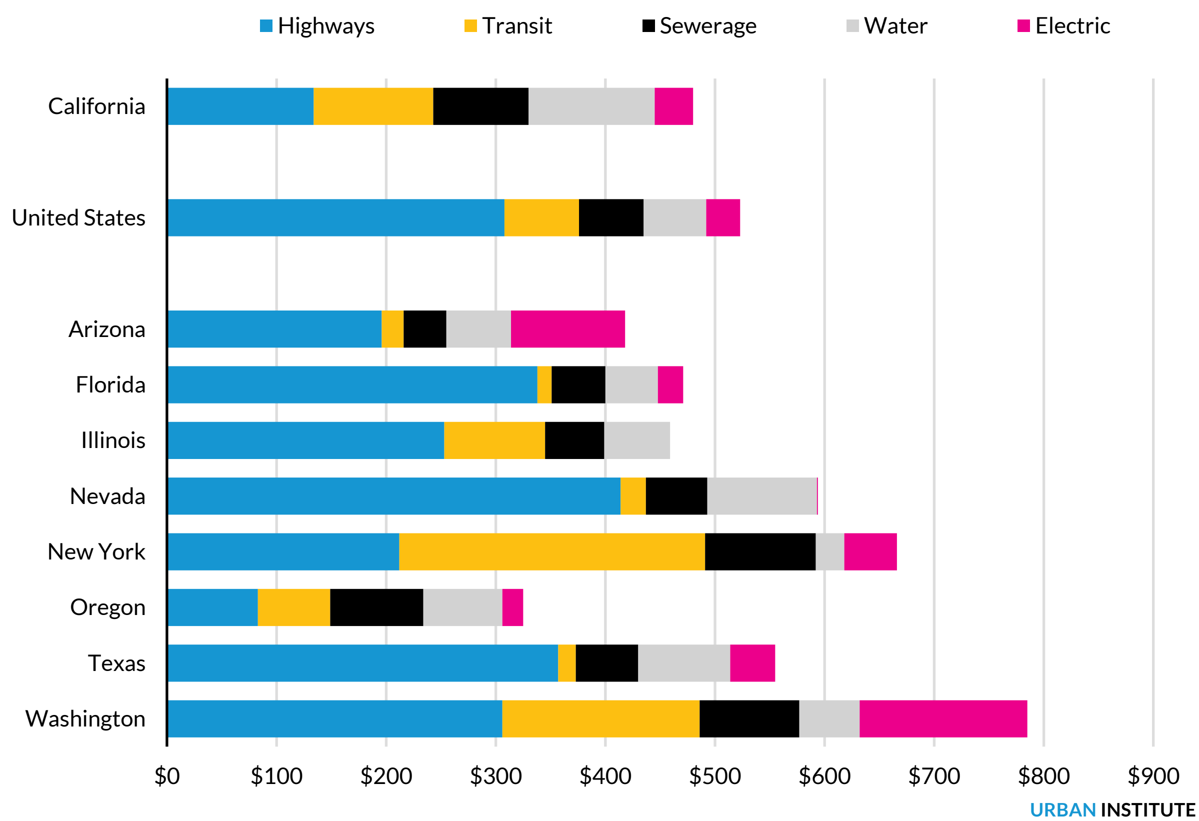
Compared with some selected states, California spent more per capita than other western states including Arizona, Nevada, and Oregon in 2017 but spent less than Washington. It spent more than other heavily populated states such as Florida and Illinois but less than New York and Texas. California's local spending share was higher than in any of these states, although very close to Oregon's (78 percent), in 2017.

Across five key sectors—highways, transit, sewerage, and water and electric utilities—California's total spending was again on par with the average state. However, California's highway spending was less than half of the average for all states and significantly below many of its peers.

FIGURE 2

State and Local Capital Outlays by major functional category, 2017

Dollars per capita



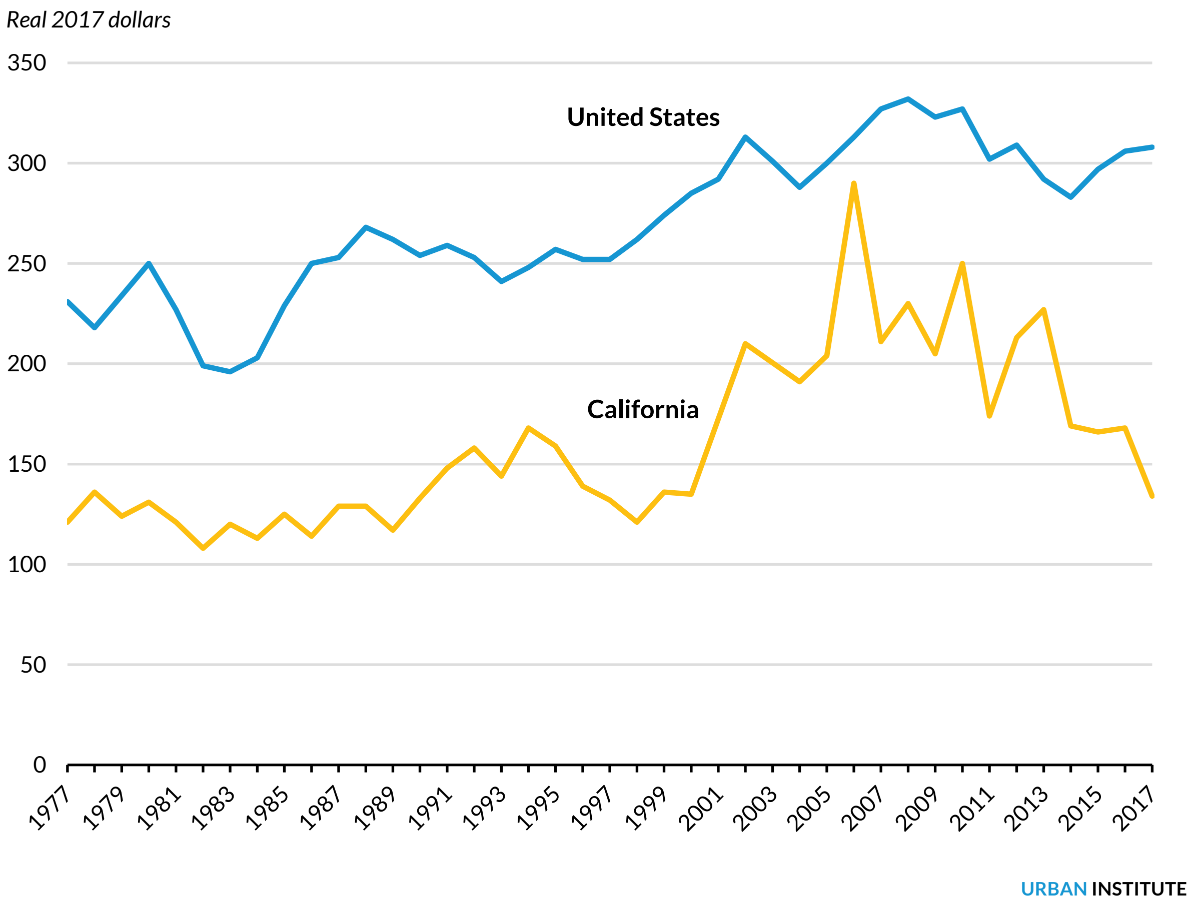
Source: US Census Bureau, Annual Survey of State and Local Government Finances.

Notes: Figure includes Regular Highways (44) and Toll Highways (45), Sewerage (80), Water Supply (91), Electric Supply (92), and Transit Utilities (97).

Evaluating capital spending in a single year can be misleading. Expenditures typically fluctuate from year to year because of planned activities or receipt of bond proceeds or federal funds. For highways, however, California's spending has been consistently below the national average since 1977.

FIGURE 3

Highway Capital Expenditures Per Capita



Source: US Census Bureau, Annual Survey of State and Local Government Finances.
Notes: The Census Bureau did not release 2001 and 2003 state-level data because of sampling issues (the line connects data from 2000 to 2002 and 2002 to 2004).

California's Infrastructure Condition

Infrastructure can be publicly or privately owned and operated.[6] Public infrastructure planning, funding, and maintenance responsibilities are typically spread across federal, state, and local government levels, each with their own financial reporting systems.[7] Assessing the condition of infrastructure and adequacy of current spending levels can therefore be difficult.[8]

The American Society of Civil Engineers compiles one comprehensive assessment of infrastructure conditions and performance based on federal, state, and local government data as well as the judgments of its members and other professional organizations.

TABLE 1

California's Infrastructure Receives Mediocre Grades

Aviation	C+	Public Parks	D+
Bridges	C-	Rail	C
Dams	C-	Roads	D
Drinking Water	C	Schools	C
Energy	D-	Solid Waste	C-
Hazardous Waste	C-	Storm water	D+
Inland Waterways	D	Transit	C-
Levees	D	Wastewater	C+
Ports	C+		

Source: American Society of Civil Engineers "Report Card for California's Infrastructure," May 2019.

One concern with the American Society of Civil Engineers' report card and related "gap analyses" or "needs assessments" is uncertainty. On the one hand, its analyses rarely incorporate the ability of prices and other incentives to modulate demand and derive more value from existing assets rather than building new ones (e.g., CBO 2016). On the other hand, these projections cannot anticipate state and federal policy changes or external events that may lead to higher infrastructure needs or costs.

Nevertheless, various metrics point to a need for infrastructure improvements in California. In transportation, California's Legislative Analyst's Office (LAO) reports that 41 percent of state roads were in good condition in 2017 while the remainder were in fair to poor condition (LAO 2019a). Moreover, although most of California's streets scored a 65 out of 100 on a pavement conditions index, many counties averaged scores in the "poor" category.

According to the Texas Transportation Institute, California had three urban areas in the nation's top 15 "most congested places to live" in 2017 (Texas A&M Transportation Institute 2019, 22). In the Los Angeles and San Francisco Bay Area metro areas, traffic delays cost the average automobile commuter more than $2,600 a year in time and excess fuel consumption. Improving infrastructure performance could thus yield significant economic gains as well as improvements to public safety and daily life.

Another theme in California infrastructure is local variation. In water resources, Hanak et al. (2014) note that water supply and sewerage utilities in larger urban areas perform relatively well, whereas systems in smaller and rural communities often have difficulties raising sufficient revenue to fund capital needs. A recent LAO report further observed considerable variation in local efforts and capacity to prepare for sea level rise as a result of global climate change (LAO 2019b).

In recent years, California has taken a few steps to address the situation statewide. For example, a 2014 ballot measure (the Water Quality, Supply, and Infrastructure Improvement Act, or Proposition 1) authorized $7.5 billion in general obligation bonds to fund ecosystems and watershed protection and restoration as well as water supply infrastructure projects.[9] And the 2017 Road and Repair Accountability Act (Senate Bill 1) provided $54 billion in transportation funds through increased fuel taxes and vehicle registration fees.

But California's limits on state and local revenues, such as voter approval requirements in Propositions 13, 218, and 26, have led to a greater reliance on bonds than in the past.

TABLE 2

Local Tax, Fee, and Bond Voter Approval Requirements

	General	Special	GO bond	Fee
City/county	Majority voter approval	2/3 voter approval	2/3 voter approval	Majority of governing board
Special district	NA	2/3 voter approval	2/3 voter approval	Majority of governing board
K–14 school district	NA	2/3 voter approval (parcel tax)	55% voter approval	Majority of governing board
State	2/3 of each house or majority voter approval	2/3 of each house or majority voter approval	Majority voter approval	Majority of each house

Source: Adapted from Coleman (2020). See also League of California Cities (2017).

Notes: NA = not applicable. User fees are for privileges, benefits, services, or products. Regulatory fees are for regulated commercial activities, permits, inspections, and licenses. Local governments also charge fees as a condition of property development and assessments or property-related fees.

Bond finance has merit for long-lived projects but also commits the state to years of elevated debt service payments (LAO 2011). Roughly half of all dollars currently spent on infrastructure goes to debt service rather than to construction costs (State of California 2017). Moreover, going to voters for bond approval can result in a "boom and bust" funding cycle that overlooks less politically popular investments. For example, Hanak and colleagues (2014) calculate a $2 to $3 billion annual funding shortfall in flood protection, storm water management, aquatic ecosystem management, and integrated management (Hanak et al 2014).

By contrast, an adequate, steady, and reliable funding source, such as a share of the revenues expected from the proposition described above, could help address future needs, regional disparities, and a significant deferred maintenance backlog. Although data on the condition and performance of local assets is unavailable, California's latest five-year infrastructure plan shows $78 billion in deferred maintenance at the state level. The backlog is heavily concentrated in transportation ($57 billion) and water resources ($13 billion; State of California 2017).

Proposition 15 would add an estimated $6 billion in annual revenue to local government budgets. This relatively steady, predictable, and reliable revenue source could help localities address long-standing infrastructure funding challenges, such as poor conditions and performance in some areas, regional inequities, and threats arising from global climate change.

Notes

[1] The property tax changes would raise between $7.5 billion and $12 billion depending on real estate market conditions. However, these revenues would be offset by decreased personal property and income taxes and

increased county administrative costs. See "A.G. File No. 2019-008," California Legislative Analyst's Office, October 2, 2019, https://lao.ca.gov/BallotAnalysis/Initiative/2019-008.

[2] Proposition 13 amended the California constitution to roll back assessed property values to 1976 levels, cap property tax rates at 1 percent, and limit growth in assessed values to 2 percent a year unless a property was sold. In addition, it established a concept of "special taxes" and required cities, counties, and special districts to obtain two-thirds voter approval to impose them. Proposition 218, another landmark measure passed in 1996, further limited local governments' ability to impose certain taxes, fees, and assessments. Proposition 26 later broadened the definition of taxes to include some fees and charges. In general, fees may not exceed the reasonable cost of the proportional special benefit conferred to those charged. See League of California Cities (2017).

[3] For example, California' per capita own-source general revenue declined faster than the national average during the Great Recession but also recovered quicker than in most states.

[4] For example, more than 60 percent of local officials identify lack of funding as a significant barrier to implementing a plan to address sea-level rise. See Moser et al. (2018).

[5] Unless otherwise noted, all data in this report are drawn from the United States Census Bureau (US Census Bureau) Annual Survey of State and Local Government Finances, 1977-2017 as compiled by the Urban Institute's State and Local Finance Data Query System. For data description and definitions, please see US Census Bureau (2006).

[6] For example, nearly 70 percent of energy and telecommunications assets in the US are privately owned. See table 1 in CBO (2004).

[7] States differ in their definition of capital versus current expenditures, usually relying on minimum expenditure and useful life thresholds as well as the nonrecurring nature of the spending to distinguish the two. Even so, the LAO notes that portions of what California's budget considers local assistance or state operations actually fund infrastructure planning and construction. See LAO (2011) and Zhao, Fonseca-Sarmiento, and Tan (2019).

[8] Zhao, Fonseca-Sarmiento, and Tan (2019) report that only 19 states and the District of Columbia prepare multi-year capital improvement plans spanning multiple state agencies (e.g., Departments of Transportation, Natural Resources, and so forth). The coverage of capital improvement plans also varies considerably, with some limited only to certain types of infrastructure, such as public buildings. In addition, only 23 states gather and release information on deferred maintenance. California is one of these states and the authors recognize its capital improvement plan as among the most comprehensive (although they note it excludes locally owned assets).

[9] As of July 2019, roughly $7 billion of Proposition 1 water bonds proceeds had been appropriated. See "Proposition 1 Allocation Balance Report, as of January 17, 2020," California Natural Resources Agency, accessed July 14, 2020, http://resources.ca.gov/docs/bonds_and_grants/Prop_1_Allocation_Balance_Report.pdf.

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