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Government Relations

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RE: Legislative Update

Budget: To date the Conference Committee has completed its first pass, and on some issues a second pass, through the agenda of outstanding budget issues. The Conference Committee met yesterday for the first in nearly a week to hear a report from the LAO on realigning the delivery of services from the state to counties.

The stall in Budget Conference Committee actions is due to an impasse over revenues. This obstacle is not limited to the obvious differences between the parties but also includes the dueling budget proposals from the Assembly Democrats and the Senate Democrats. For the past week the Speaker's Office has been meeting with Senate Pro Tem's Office in an effort to reach a consensus on a spending plan both Assembly and Senate Dem caucuses could support.

They are working to resolve differences with the tax proposals in the Senate's Budget, the revenue pieces included in the Assembly's Jobs Budget, as well as funding for Education, and cost shifts to counties. On this last item, Senator Steinberg unveiled a proposal to realign numerous program obligations from the state to counties. This proposal is discussed below. In addition, the Speaker has backed-off on the Assembly's plan to issue \$8.7 billion in revenue bonds to fund programs. Both the Attorney General's Office and the Treasurer's Office have stated that the revenue bond proposal violates Prop 58.

A summary of the transportation actions and relevant open items is outlined below, as well as a comparison of the Senate and Assembly's budget plans. The current status of the Conference Committee and leadership negotiations clearly indicates that the Budget will not be passed anytime soon -- legislators are simply moving through the process as usual.

Cash Status: According to State Controller John Chiang, the State will face a cash shortage at the end of September whether the Budget is passed or not. \$20 billion in loans from the State's special funds have delayed the shortage this year, but the Controller hopes to avoid cash-saving measures such as IOUs. The downside to this fortunate cash flow news is that the budget stalemate could last well into August.

Revenues: May revenues were \$592.2 million higher than expected due to higher personal income taxes and corporate income taxes. Overall, the year-to-date revenue total is 0.8% higher than budgeted.

Senate Realignment Plan Released: Surrounded by six of his committee chairs, Senate President Pro tem Darrell Steinberg introduced the “Senate Democrats’ Multi-Year Government Restructuring Proposal” at a press conference earlier this week. It is intended to become a key piece of this year’s budget solution as well as help to address out year deficits. We did not include the Senate’s summary of this proposal, but if you would like a copy please contact our office.

The proposal would transfer public safety programs for which the state is currently responsible to counties; increase the county share of various elements of the CalWORKs program; realign Adult Protective Services and Aging programs to counties; and give counties additional revenues to pay for the restructured services. The plan also shifts responsibility for juvenile parole services, low-level offenders, Drug-Medi-Cal, offender treatment programs and drug court program to counties, while restoring Substance Abuse and Crime prevention Act funding to counties and maintaining existing funding for COPS/Juvenile Justice program.

Steinberg indicated that restructuring is essential because even if the Legislature adopted all the cuts in the Governor’s May Revision, they would still be faced with a \$6 billion deficit next year and no where left to cut. “Investment is imperative,” to avoid further layoffs and reduce unemployment across the state. He is convinced that the voters understand this because seventy-five percent of local tax measures on the June ballot were approved. Further, since the passage of Proposition 13, so much of what the state does is just passing through funds to local agencies. This results in a lack of transparency and accountability. Steinberg did observe, however, that his plan would not work without a partnership with counties.

Steinberg explained that his plan will take three to four years to implement and that it is an intelligent way to make state government smaller. It places services with those who can provide them best – the counties – along with separate revenue sources to pay for them. It would be financed with a new oil severance tax, continuing the current (increased) level in the Vehicle License Fees and dedicating them to counties, transferring other DMV funds to counties, capturing the “savings” that counties will experience when indigent adults become eligible for Medi-Cal in 2014, delaying the corporate tax breaks that were set to begin this year, and dedicating a portion of the state’s sales tax as “bridge” funding until other dollars are available.

When asked about potential Republican opposition to these revenues, Steinberg’s reply was, “There are no new big taxes here. If you are going to plant your flag around revenue, plant it around long term reform.” (Frankly, this is how Governor Pete Wilson was able to secure the votes for Realignment in 1991.) When asked if counties should fear the state reaching into their pockets, the President Pro Tem’s reply was, “The number one protection for the counties is the state getting its fiscal house in order.”

Budget Conference Committee: The Senate and Assembly Democrat Caucuses adopted two very different proposals to bridge the budget deficit. The Senate generally proposed extending various taxes that are scheduled to sunset next year, while the Assembly adopted a complicated, yet creative, majority vote proposal. The LAO produced the following chart comparing the Governor’s May Revise with the Senate and Assembly proposals.

	Governor’s May Revise	Assembly	Senate
Revenues	\$91.5 billion	\$93.6 billion	\$96.8 billion
Key Revenue Differences	Limited additional revenue	<ul style="list-style-type: none"> • Suspends previously approved corporate tax reductions. • Imposes oil severance tax and decreases state sales tax by 1/4 cent. 	<ul style="list-style-type: none"> • Suspends or changes previously approved corporate tax reductions. • Extends temporary income tax increases scheduled to expire in 2010-11, increases vehicle license fee, and raises alcohol taxes.
Expenditures	\$83.4 billion	\$86.1 billion	\$93.1 billion
Key Expenditure Differences	Elimination of CalWORKs and child care. Sharp reductions in other health and social services programs.	<ul style="list-style-type: none"> • Generally preserves existing health and social services programs. • Beverage container recycling borrowing reduces expenditures by nearly \$8 billion. 	Generally preserves existing health and social services programs.
Prop 98 Spending	\$48.9 billion	\$54.0 billion	\$51.2 billion
Reserve	\$1.2 billion	\$1.2 billion	-\$2.1 billion
LAO Estimated Operating Deficit	\$5 billion	\$16 billion	\$12 billion

Governor’s May Revise: Governor Schwarzenegger’s May Revision outlined a \$17.9 billion deficit. To close the deficit and provide a \$1.2 billion reserve the Governor is proposing \$19.1 billion in solutions: \$12.4 billion in spending reductions, \$3.4 billion in additional federal funds, \$1.3 billion in alternative funding, and \$2.1 billion in fund shifts and other revenues. Here are some highlights of the reductions:

- The elimination of CalWORKs (\$1.1 billion).

- Elimination of \$602 million in realignment funding for mental health programs.
- \$257 million in savings resulting from an IHSS proposal which has yet to be fleshed out, and is currently awaiting input from an undesignated stakeholder group.
- Elimination of subsidized child care except preschool and after school care (\$1.2 billion).
- House non-serious offenders with sentences of less than 3 years in county jails. This proposal would provide block grants to counties at \$11,500 per inmate which would be used for probation services for the inmates that must be released in order to make room for state inmates. The State would score a savings of \$243.8 million.
- \$1.2 billion in transportation and motor vehicle account funds are loaned or transferred to the general fund.

Senate Budget: The Senate Democrats unveiled a \$4.9 billion package of tax increase that would restore the Governor’s proposed cuts to health and social service programs, as well provide additional education funding. The Senate proposal would generate additional revenue through the following changes:

- Suspension of the corporate tax breaks agreed upon last year, which is scheduled to go into effect on January 1, 2011. (\$2.05 billion)
- Extension of the 0.25 percent income tax surcharge scheduled to end Dec. 31, 2010 (\$1 billion).
- Extension of the \$217 per dependant reduction in the state’s dependent income tax credit, scheduled to end Dec. 31, 2010 (\$430 million).
- Increase in VLF from 1.15 percent to 1.50 percent starting July 1, 2010 (\$1.2 billion).
- Increase in the state’s alcohol tax by an inflation-adjusted amount (\$210 million).

Assembly Jobs Budget: The Assembly unveiled its creative/confusing, “Jobs Budget” proposal. This complicated tangle of revenue streams relies on the revenue neutrality trick to impose an oil severance tax, and in a round about way securitizes some of that new tax revenue in exchange for \$8.7 billion from Wall Street. This proposal does not need any Republican votes for passage. The Assembly Dems plan is structured as follows:

Tax swap: Reduce the state’s sales tax rate by .25% and impose an oil severance tax. The \$1.1 billion oil severance tax revenue would be deposited into the Jobs & Economic Security Fund.

Partial Reverse of the Triple Flip: As you may recall, the “triple flip” was another cumbersome maneuver where cities and counties gave up .25% of the Bradley-Burns sales tax rate in exchange for an equal amount of property tax revenue. This was done to dedicate a ¼ cent of the sales tax for paying off the economic recovery bonds. As part of this agreement, the local Bradley-Burns rate would automatically increase if the property tax backfill is not provided. Under the Jobs

Budget, the state would stop the property tax backfill. This would trigger a shift of property tax revenue back to schools, the Bradley-Burns rate would automatically increase by ¼ cent, and the state will receive about a \$900 million general fund benefit. The overall sales tax rate statewide would remain unchanged.

Issuing More Debt: In order to fund CalWORKs, childcare, and education, the plan would essentially deposit \$200 million a year of the oil severance tax revenue in the Beverage Container Recycling Fund and then borrow \$8.7 billion dollars against the Recycling Fund revenue stream. These funds along with a \$500 million loan from the Disability Insurance Fund, and the remaining \$900 million in oil severance tax revenue creates the \$10.1 billion Jobs and Economic Security Fund. The Jobs and Economic Security Fund would be used to restore cuts and provide new investment in various programs.

However, the Assembly Democrats have reduced the size of this borrowing plan from nearly \$9 billion to \$4 billion. Attorney General Jerry Brown released an opinion last week stating the \$8.7 billion plan would violate Prop 58, which amended the Constitution to prohibit borrowing to balance the budget. The Assembly Dems feel the reduced bonding amount of \$4 billion would have stronger legal footing. The revenue would be used for job creation incentives (\$1.1 billion), local government mandates (\$900 million), reduce UC and CSU fees (\$900 million), and remainder would be used to fund education programs outside the Prop 98 guarantee.

Transportation: The following is a summary transportation items included so far in the budget. The Budget does not propose any changes to the gas tax swap or the transit funding measures approved in March. The following items have been adopted:

- \$650 million in gasoline excise tax revenues loaned to the General Fund with a repayment date of June 2013. The gas tax swap enacted in March included an “excess” \$650 million in new excise tax revenue that was not allocated to the SHOPP, STIP, or Local Street and road programs. The Governor proposes to loan these unallocated funds to the General Fund. When the funds are repaid in 2013, the Governor proposes that these funds be used for state highway maintenance projects.
- \$230 million in existing loans from the State Highway Account to the General Fund will be repaid June 2012 instead of June 2011.
- \$250 million in Motor Vehicle Account funds are loaned to the General Fund. The Summary notes that this loan is dependent upon the adoption of staffing reduction proposed by the Governor.
- \$72.2 million in non-Article 19 funds in the Motor Vehicle Account are transferred to the General Fund. Non-Article 19 funds are primarily from rents and document sales and are not constrained by Article 19 of the Constitution.
- Privacy Protection: The Conference Committee adopted the Assembly version, basically rejecting the Senate proposal. The Senate budget included budget bill

language requiring the CTC to include in its public-private partnership guidelines a prohibition on toll operators selling personally identifiable vehicle information. This action essentially pushes this issue back into the regular legislative process.

- Message Signs: The Governor proposed to upgrade the changeable message signs and allow for advertising on these signs. The Conference Committee adopted the Senate version. While both the Senate and Assembly budgets rejected this proposal, the Senate version also included budget bill language explicitly stating that the Administration cannot implement this proposal without legislative approval.
- Prop 42/ Fuel Tax Swap Clean-up: The Conference Committee approved the Assembly version. The Assembly adopted trailer bill language to clarify how the new excise tax revenues that are intended to backfill the lost Prop 42 are allocated. First, Prop 42 local street and road funds were allocated quarterly. Since the backfill funds are allocated by the HUTA formula, the language clarifies that the Prop 42 backfill funds for local streets and roads is allocated monthly, instead of quarterly. In addition, the Prop 42 maintenance of efforts requirements for local street and road funds do not apply to the backfill funds. The Senate budget did not address this issue.
- Prop 1B – Local Streets and Roads Funds: The Conference Committee adopted the Senate version. The Senate adopted trailer bill language extending the use-or-lose period from three years to four years on Prop 1B local streets and roads funds whenever the state defers the allocation of HUTA funds to a city or county. The Assembly budget did not address this issue.
- Prop 1B Bond Appropriations: The budget appropriates \$4.2 billion in Prop 1B bonds. The intent of these higher appropriations is to move projects forward that are ready to go as quickly as possible. This action includes increasing the Governor's proposed appropriation for transit capital projects from \$350 million to \$1.5 billion, the appropriation from the State and Local Partnership Program from \$200 million to \$240 million, and increasing the appropriation for the Traffic Light Synchronization program from \$80 million to \$182 million. Since the transit capital bonds are allocated based on the STA formula and it allows recipients to swap allocations, it is estimated that over \$700 million could be expended in 2010-11. Unallocated funds would automatically carry over to the next fiscal year.

OPEN ITEMS

- Project Initiation Documents: The Conference Committee has not acted on this item. The Governor proposed to shift \$7.4 million in costs for Project Initiation Documents from the State Highway Account to local reimbursements. The Assembly rejected the Governor's funding shift proposal and adopted trailer bill language to require local reimbursements only where the project was approved by the electorate. The Senate reduced the Governor shift by \$1,000 in order to ensure that this item is revisited by the Conference Committee.
- High Speed Rail Authority: While the Conference Committee has approved funding for accounting and risk management positions, and the Executive Director's salary, there remain several open issues. The open items primarily

relate to the oversight of the Authority's activities. We expect the Conference Committee will adopt extensive budget and trailer bill provisions on how the Authority spends bond and federal ARRA funds.

Initiative Verification: Yesterday was the deadline for the Secretary of State's Office to qualify initiatives for the November ballot. Six have already qualified; these include the water bond proposal, legalizing marijuana, changing the congressional redistricting process, prohibiting the state from taking transit funds or local property taxes, suspending AB 32 greenhouse gas emission regulations, and increasing vehicle registration fees to fund state parks.

The following is summary of some of those initiatives that qualified yesterday.

Majority-Vote Budget: The measure would allow the Legislature to pass the State budget with a majority vote, but would maintain the 2/3 vote requirement for raising taxes and would withhold lawmakers' pay when the budget is late.

2/3 Vote on Fees: The supporters of the Stop Hidden Taxes initiatives have submitted 1.1 million signatures. This initiative would basically require a 2/3 vote on any state or local tax or fee.

Repeal Business Tax Credits: This initiative would repeal legislation that would allow businesses to shift operating losses to prior years, and extend the time period for shifting operating losses to future years. It would also repeal the ability to use a sales-based income calculation in order to lower taxable income.