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RE: Legislative Update

Budget Conference Committee: With the release of the May Revise and the Senate and Assembly counter proposals, the Budget Committees in both houses quickly finished their work and made the parliamentary maneuvers to place vehicle in conference. Senate President Pro Tempore Steinberg has named Senators Denise Ducheny (Chair), Alan Lowenthal, Mark Leno, Bob Dutton, and Bob Huff to the Conference Committee, and Speaker Perez has selected the following Conferees Assembly members Bob Blumenfield, Felipe Fuentes, Nancy Skinner, Connie Conway, and Jim Nielsen.

Today marks the first meeting on the Conference Committee. No significant actions are expected today other than opening remarks and an overview of the state fiscal situation from the LAO and the Department of Finance. Work is expected to begin in earnest on Monday with transportation and resource issue being first on the agenda.

The following are the main transportation items to be resolved by the Conference Committee:

- **Privacy Protection:** The Senate adopted budget bill language requiring the CTC to include in its public-private partnership guidelines a prohibition on toll operators selling personally identifiable vehicle information.
- **Project Initiation Documents:** 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.
- **Message Signs:** The Governor proposed to upgrade the changeable message signs and allow for advertising on these signs. The Assembly rejected this proposal. The Senate also rejected this proposal, but also adopted budget bill language explicitly stating that the Administration cannot implement this proposal without legislative approval.
- **Prop 42/ Fuel Tax Swap Clean-up:** The Assembly adopted trailer bill language to clarify how the new excise tax revenues that are intended to backfill the lost Prop 42 funds 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 took no action on this issue.

- **Prop 1B – Local Streets and Roads Funds:** 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 took no action on this issue.

May Revision Snapshot: Governor Schwarzenegger released his May Revision on May 14 outlining the expected horrors. The state faces 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.

Transportation: The following is a summary of the May Revise changes to transportation accounts. The May Revise does not propose any changes to the gas tax swap or the transit funding measures approved in March. If you would like information on other budget areas, please contact our office. The May Revise proposes to loan \$1.2 billion to the General Fund from transportation accounts. The following loans have been adopted by both the Assembly and Senate Budget Committees and they are not expected to be debated as part of the Conference Committee agenda:

- \$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.

The Counter Strikes: Both the Senate and Assembly each rebutted the Governor’s objectionable cuts with their own proposals. Senate Democrats unveiled a \$4.9 billion package of tax increases that include the following:

- 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).

Jobs, Jobs, Jobs Budget: The Assembly unveiled its creative/confusing, “Jobs Budget” proposal. This complicated mess 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 as we currently understand it 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.

Issuing More Debt: In order to reject the Governor’s proposed cuts to CalWORKs, childcare, and education, the plan essentially would deposit \$200 million a year of the oil severance tax revenue in the Beverage Container Recycling Fund and then barrow \$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. The \$10.1 billion in funds would be spent as follows:

- **\$1.1 Billion Targeted Jobs Investment** to develop and strengthen California industries, including green and clean tech industries.
- **\$900 million Repayment to Local Governments.** These funds would reimburse local governments for prior mandate claims.
- **\$3.8 Billion Repayment to Local School Districts.** This would fully fund Proposition 98 and eliminate a portion of the structured settlement the state owes schools
- **\$900 million to Protect Higher Education's Role in Our Economic Future.** This would fully fund the UC and CSU. Also reduces the Governor's student fee hike by 50 percent, which will save UC students \$628 and CSU students \$202.
- **\$1.9 Billion Keeping Working Poor Parents in Workforce.** Maintains necessary childcare programs funded through CalWORKS and Prop 98 to ensure working parents can stay employed and over 50,000 small business childcare providers can stay in business.
- **\$1.4 Billion Getting Californians Back to Work.** Invests in critical employment services to move people from welfare to work and to retrain workers at Community Colleges.
- **\$100 Million for Oil Producing Communities.** Provides \$100 million to local communities impacted by the new Oil Severance Fee. Experts project the Oil Severance Fee will have little impact on jobs state wide, but there may be localized impacts. Therefore, an ongoing \$100 million allocation is included to offset any negative impacts of the fee.

Other Budget Actions: On May 13 the Senate Budget Subcommittee #2 voted to appropriate \$4.2 billion in Prop 1B bonds. Last week, the Assembly Budget Subcommittee #5 adopted a proposal that conforms to the Senate's action. This means the Prop 1B appropriations will not be discussed as part of the Budget Conference Committee. While staying out of conference is preferred, it does not guarantee that these appropriations will stay out of the budget negotiations.

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.

Initiative Verification: The Secretary of State's Office is working overtime to verify millions of signatures submitted for various initiatives. The following is summary of some of these initiatives:

Majority-Vote Budget: Supporters of a majority vote budget initiative have submitted signatures to the Secretary of State to qualify the measure for the November 2nd ballot.

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.

Local Revenue Protections: The supporters of the Local Taxpayer, Public Safety, and Transportation Protection Act of 2010 initiative have submitted 1.1 million signatures for verification in order to place this initiative on the November ballot. This initiative makes numerous changes intended to protect local funding sources from state raids. This proposal would eliminate the ability of the state to loan property tax revenues to schools, withhold highway user tax subventions, protect redevelopment funds, and prevents the state from redirecting local Transportation Development Act funds.

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.

California Forward Reform: The Assembly Budget Committee has twice postponed voting on the reform package. The Senate Budget Committee also has not taken any action; however the Senate Budget Committee did move forward some elements of the reform proposal. The Senate Budget Committee unanimously approved SB 1020 and SB 1426. The Senate has since approved both of these bills with nearly unanimous support.

SB 1020 was amended to require the Legislature to establish a process for reviewing the performance of all state programs at least once every ten years, including tax expenditures. In addition, SB 1020 would require the implementation of performance based budgeting.

SB 1426 was amended to contain requirements for longer-term, 5 year, budget planning. This bill requires the Governor to submit a budget for both the budget year and the succeeding fiscal year, as well projections of state expenditures and revenues for the three fiscal years following the fiscal year succeeding the budget year. In addition, SB 1426 requires that if the Governor's budget expands or creates a new program or expand the scope of an existing program, which results in an increase in state costs or reduces a state tax the proposal must be accompanied by a statement identifying how those programs are paid for.