<table>
<thead>
<tr>
<th>Resources</th>
<th>2013-14</th>
<th>2014-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior Year Balance</td>
<td>$2,528</td>
<td>$4,212</td>
</tr>
<tr>
<td>Revenues and Transfers</td>
<td>$100,147</td>
<td>$104,503</td>
</tr>
<tr>
<td>Total Resources Available</td>
<td>$102,675</td>
<td>$108,715</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Proposition 98 Expenditures</td>
<td>$57,515</td>
<td>$61,731</td>
</tr>
<tr>
<td>Proposition 98 Expenditures</td>
<td>$40,948</td>
<td>$45,062</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>$95,463</td>
<td>$106,793</td>
</tr>
<tr>
<td>Fund Balance</td>
<td>$4,212</td>
<td>$1,922</td>
</tr>
<tr>
<td>Budget Stabilization Account / &quot;Rainy Day Fund&quot;</td>
<td>$1,591</td>
<td></td>
</tr>
</tbody>
</table>
California’s Fiscal Outlook

Continued moderate economic expansion, “Slow, Steady growth”
- Unemployment rate falling – and more quickly than U.S.
- Inflation expected to remain just under 2% /yr
- Trends favor multifamily over single family housing
- But … economic expansions do not last forever.

Revenues improved
- Improved revenues primarily due to personal income taxes from capital gains in 2014 and 2013.

Governor’s Proposed Budget 2014-15

General Fund Revenues

<table>
<thead>
<tr>
<th></th>
<th>2013-14</th>
<th>2014-15</th>
<th>$ change</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income Tax</td>
<td>$64,287</td>
<td>$69,764</td>
<td>$5,477</td>
<td>8.5%</td>
</tr>
<tr>
<td>Sales and Use Tax</td>
<td>$22,920</td>
<td>$24,071</td>
<td>$1,151</td>
<td>5.0%</td>
</tr>
<tr>
<td>Corporation Tax</td>
<td>$7,971</td>
<td>$8,682</td>
<td>$711</td>
<td>8.9%</td>
</tr>
<tr>
<td>Insurance Tax</td>
<td>$2,143</td>
<td>$2,297</td>
<td>$154</td>
<td>7.2%</td>
</tr>
<tr>
<td>Alcoholic Beverage Taxes and Fees</td>
<td>$350</td>
<td>$357</td>
<td>$7</td>
<td>2.0%</td>
</tr>
<tr>
<td>Cigarette Tax</td>
<td>$89</td>
<td>$86</td>
<td>-3</td>
<td>-3.4%</td>
</tr>
<tr>
<td>Motor Vehicle Fees</td>
<td>$20</td>
<td>$20</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Other</td>
<td>$2,367</td>
<td>$817</td>
<td>-1,550</td>
<td>-65.5%</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$100,147</strong></td>
<td><strong>$106,094</strong></td>
<td><strong>$5,947</strong></td>
<td><strong>5.9%</strong></td>
</tr>
</tbody>
</table>
California State Budget Outlook
Voter Approved Revenues

✔ Personal Income Tax (Prop30)
✔ Sales and Use Tax (Prop30)
✔ Corporate Tax simplification (Prop39)

Governor’s Proposed Budget
State General Fund and Realignment Fund Revenue

- Personal Income Tax: $69,764, 59%
- Sales & Use Tax: $24,071, 20%
- Corporation Tax: $9,682, 8%
- Realignment Sales Tax: $5,569, 8%
- Insurance Tax: $2,297, 2%
- Vehicle License Fee: $2,071, 2%
- Other/Transfers: $1,281, 1%
Governor’s Proposed Budget
State General Fund and Realignment Fund Spending

California’s Fiscal Outlook
Risks

- **Threat of Recession.** It’s inevitable.
- **Federal Challenges** – Congressional action/inaction.
- **Redevelopment Dissolution.** Recent court decisions “put funds at risk.”
- **Health Care Costs.** Medi-Cal is budget’s 2nd largest program.
- **Natural Disasters:** draught, fires, flood, earthquake.
- **Debts and Liabilities.** In addition to budgetary debt:
  - $218 billion state retirement-related unfunded liabilities
  - $65 billion deferred maintenance
  - $9 billion unemployment insurance
- **Capital Gains** (10% of General Fund tax revenues) volatile, affected by stock market behavior.
California’s Fiscal Outlook

Risks

Capital Gains are Extremely Volatile
year over year percentage change

LAO’s Hypothetical Recession

Operating Deficits Return Under Hypothetical Recession Scenario

General Fund and Education Protection Account Combined (in Billions)

2013-14  2014-15  2015-16  2016-17
Governor’s Proposal for Rainy Day Reserves

Proposition 58 (2004)
- Requires 3% of estimated General Fund revenues deposited to Budget Stabilization Account (BSA)
- Half of BSA deposit repays Economic Recovery Bonds (ERBs) early until repaid.
- Deposits continue until BSA reaches $8 billion or 5%.
- Used in 2006-07 and 2007-08, then emptied.
- Suspended – not used since then.

Governor: replace Prop58 mechanism
- Increase size to 10% of estimated General Fund.
- Annual required deposit
  - Size based on capital gains income tax revenues exceeding 6.5% of annual General Fund revenues.
- Proposition 98 component:
  - attributable amount counts against current year guarantee but to be used when guarantee drops.
- May pay down budgetary debt instead of depositing to reserve.
Eliminating the “Wall of Debt”

For FY2014-15, the Governor proposes to...
- Pay down remainder of school deferrals $6.2 billion
- Pay off Economic Recovery Bonds early $1.6 billion
- Repay special funds $1.6 billion

Governor’s Proposed Budget

Infrastructure

Governor’s Proposal for Deferred Maintenance ($ in millions)

<table>
<thead>
<tr>
<th>Department</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caltrans - State Highways</td>
<td>$237</td>
</tr>
<tr>
<td>Caltrans - Local Streets and Roads</td>
<td>$100</td>
</tr>
<tr>
<td>K-12 Schools Emergency Repair</td>
<td>$188</td>
</tr>
<tr>
<td>Community Colleges</td>
<td>$175</td>
</tr>
<tr>
<td>Parks &amp; Recreation</td>
<td>$40</td>
</tr>
<tr>
<td>Corrections &amp; Rehabilitation</td>
<td>$20</td>
</tr>
<tr>
<td>Judicial Branch</td>
<td>$15</td>
</tr>
<tr>
<td>Developmental Services</td>
<td>$10</td>
</tr>
<tr>
<td>State Hospitals</td>
<td>$10</td>
</tr>
<tr>
<td>General Services</td>
<td>$7</td>
</tr>
<tr>
<td>State Special Schools</td>
<td>$5</td>
</tr>
<tr>
<td>Forestry and Fire Protection</td>
<td>$3</td>
</tr>
<tr>
<td>Military</td>
<td>$3</td>
</tr>
<tr>
<td>Food and Agriculture</td>
<td>$2</td>
</tr>
<tr>
<td>Total</td>
<td>$815</td>
</tr>
</tbody>
</table>

$500m in bond authority for jail constr.
Water Plan: $618m for groundwater basin protection, local water supplies, flood protection.

Governor’s Proposed 2014-15 Cap-and-Trade Expenditure Plan ($ in millions)

<table>
<thead>
<tr>
<th>Department</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-Speed Rail Authority</td>
<td>$250</td>
</tr>
<tr>
<td>Air Resources Board</td>
<td>$200</td>
</tr>
<tr>
<td>Strategic Growth Council</td>
<td>$100</td>
</tr>
<tr>
<td>Community Svcs and Dev.</td>
<td>$80</td>
</tr>
<tr>
<td>Caltrans</td>
<td>$50</td>
</tr>
<tr>
<td>Forestry and Fire Protection</td>
<td>$50</td>
</tr>
<tr>
<td>Fish and Wildlife</td>
<td>$30</td>
</tr>
<tr>
<td>CalRecycle</td>
<td>$30</td>
</tr>
<tr>
<td>Total</td>
<td>$850</td>
</tr>
</tbody>
</table>

*HUTA=*Highway Users Tax Account* revenue AKA Gas Tax
Governor’s Proposed Budget
Local Government Issues

- **Supplemental Law Enforcement** funding continued at $27.5 million (began 2012 with Prop30)
- **State law enforcement grant program continued.** (since 2011 funded from VLF shifted from cities)
  - COPS Frontline Law Enforcement program at same level (SLESA)
  - Jail Detention Facility Grants (in lieu of booking fees)
- **Insufficient ERAF compensation** for cities/counties in Alpine, Amador, San Mateo. (re triple flip, VLF swap)
- **State-County Assessors’ Partnership Agreement Program.**
  - Three year program, $7.5 million/yr for nine chosen counties with matching funds to catch-up on property assessment.
  - $3.3 million for **public libraries** for equipment to access high-speed internet networks.

**Governor’s Proposal for Infrastructure Financing Districts**

"Given that current compliance with the RDA dissolution statutes is improving, the Budget proposes expanding the IFD tax increment financing tool."

- **Expand IFD use** to military base reuse, urban infill, transit priority projects, affordable housing, related consumer services. Goal: "Maintain focus on projects with benefits for residents of the IFD project area."
- Create IFD, issue related debt **subject to 55% voter approval.**
- Allow new IFD project areas to overlap with the project areas of the former RDAs.
- No tax revenues from K-14 schools, **no state impact.**
- **Any participating** county, cities, and special district that would contribute their revenue, **must approve.**
- **Must have RDA Finding of Completion,** compliance with SCO audit findings, conclusion of any outstanding legal issues.
Game Over for New Cities and Annexations?

Pernicious Effects of the VLF-Property Tax Swap of 2004

The VLF-Property Tax Swap of 2004

State General Fund

$4.4 b

VLF Backfill

Cities & Counties

Property Tax in Lieu of VLF

$4.4 b

Schools

$4.4 b

* in FY2004-05
The Lack of VLF Replacement Makes New Cities Fiscally Unviable

The Lack of VLF Replacement Makes many Annexations Fiscally Unviable
Ending the Triple Flip

Can we stick it?

Where Your Sales Tax Goes

<table>
<thead>
<tr>
<th>Source</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Fiscal Res Fund</td>
<td>0.25%</td>
</tr>
<tr>
<td>City*</td>
<td>0.75%</td>
</tr>
<tr>
<td>Co Transp</td>
<td>0.25%</td>
</tr>
<tr>
<td>Prop172</td>
<td>0.50%</td>
</tr>
<tr>
<td>Co Realign</td>
<td>1.5625%</td>
</tr>
<tr>
<td>State GF</td>
<td>3.9375%</td>
</tr>
<tr>
<td>Prop30</td>
<td>0.25%</td>
</tr>
<tr>
<td><strong>Total Base</strong></td>
<td>7.50%</td>
</tr>
</tbody>
</table>

* For taxable sales in unincorporated areas, the local 1% rate goes to the county.

** ¼% Prop30 rate effective 1/1/2013 expires 12/31/2016
The Triple Flip
property tax for sales tax

Increase State Sales
Tax Rate +0.25%

Decrease Local Sales
Tax Rate -0.25%

Cities & Counties

Property Tax
in Lieu of Sales Tax

State Fiscal
Recovery Fund

State General
Fund

$1.4 b

Schools

$1.4 b

Triple Flip Timing
City/County Sales Tax Compensation
The Triple Flip

Take-aways

- **Expected to end in 2015-16**
  - From debt service from ¼% state sales tax
  - Likely residual wind-down into 2016-17
- **Governor proposing addt’l $1.6 billion**
  - Payment from general fund in FY2014-15
  - Would end the Triple Flip in 2014-15 with residual effects into 2015-16.
- Prop1A (2004) prevents any mischief
- One time boost of revenue at end
  - Equivalent to 1.5 months of your sales tax

H.U.T.A. Headaches

The Fuel Tax Swap of 2010
California Sales Tax
*allocation before 2010*

- State Sales Tax: 5% of sale
- County Transportation: ¼¢
- County Health/Welfare: ½¢
- Prop172 Public Safety: ½¢
- City/County: 1¢
- Add-on: varies

Motor Vehicle Fuel Taxes
*before 2010*

- State Sales Tax: 5% of sale
- Federal Fuel Excise Tax: 18.4¢
- State Fuel Excise Tax: 18¢

Under *Proposition 42 (2002)*, the state sales tax rate on gasoline and diesel is dedicated to transportation.
Motor Vehicle Fuel Taxes
before 2010

- State Sales Tax
  5% of sale
- State Fuel Excise Tax
  18¢

Revenues

State Sales Tax
5% of sale

Base Fuel Excise Tax
18¢

Allocation

- Public Transit Acct
- Prop42 Transit Acct
- Prop42 State Hwy Acct
- Prop42 City&Co
- State Highway Acct
- City&Co HUTA

February 19-21, 2014
CaliforniaCityFinance.com
Motor Vehicle Fuel Taxes
Fuel Tax Swap of 2010

Revenues

$6
$5
$4
$3
$2
$1
$0

Swap Excise Tax 21.5¢ (variable)

Base Fuel Excise Tax 18¢

Allocation

Public Transit

State Transportation Debt Service

State Highway Acct

City&Co §2103

State Highway Acct

City&Co HUTA

Highway User Tax Revenues
Allocation

39.5¢ Per Gal Gasoline

18¢ base rate

Transportation Debt Service
State General Fund Relief

Weight Fees ~$900 million

21.5¢ Swap rate (varies)

Weight Fee Offset ~$900 mil

State Highway Account

44%

Counties

22%

Cities

22%

Remainder

Str&Hwys §§2104-2108

Str&Hwys §2103

State Highway
Account

Cities

Counties

State Highway
Account

CaliforniaCityFinance.com
Highway User Tax Revenues

Take-aways

- Base HUTA (§§2104-2107) revenue growth is flat, will decline in future.
- §2103 revenue is complex and volatile.
- FY2014-15 proposed budget includes $100 million loan repayment to HUTA for cities & counties (Sec 2104-2107)
  - This is not in the projections. Don’t count on it yet.
- Estimates will be updates in May.