Local Budgets

- Taxable sales up ... regional variation
- Property tax growth is flat – turned around in most areas
- Short term band-aids are gone
- Pension/OPEB problems are huge and cannot be ignored
  
  2012 reform package is very helpful ... but more is needed
- Redevelopment dissolution could not have come at a worse time. Not just the revenue loss ... uncertainty & workload.

What will the State Legislature do? Fix? Shift?
Staff & councils are overwhelmed
Some key players believe the recovery will solve it *(wrong!)*
Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Over-reliance on redevelopment revenues
- Risky financing schemes
- Fear & Denial
- Toxic relationships
- Ceding of management and policy choices to others
- Unsustainable and Intractable employee compensation, especially public safety pension and retiree health care
- Unsustainable Decline in Core Revenues

The State of the State:
Governor’s Proposed Budget 2014-15
Governor’s Proposed Budget 2014-15

2014-15 Governor’s Budget
General Fund Budget Summary

($ in millions)

<table>
<thead>
<tr>
<th></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>
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<tr>
<td>Expenditures</td>
<td></td>
<td></td>
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<tr>
<td>Non-Proposition 98 Expenditures</td>
<td>$57,515</td>
<td>$61,731</td>
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<tr>
<td>Proposition 98 Expenditures</td>
<td>$40,948</td>
<td>$45,062</td>
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<tr>
<td>Total Expenditures</td>
<td>$95,463</td>
<td>$106,793</td>
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<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 State Budget Outlook

Voter Approved Revenues

☑ Personal Income Tax (Prop30)
☑ Sales and Use Tax (Prop30)
☑ Corporate Tax simplification (Prop39)
California’s Fiscal Outlook

Risks

- **Threat of Recession.** It’s inevitable.
- **Federal Challenges** – action/inaction.
- **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.

Capital Gains are Extremely Volatile

year over year percentage change

[Graph showing year over year percentage change for capital gains from 1971 to 2013]
LAO’s Hypothetical Recession

Operating Deficits Return Under Hypothetical Recession Scenario

General Fund and Education Protection Account Combined (In Billions)

Governor’s Proposed Budget 2014-15

Reserves, Rainy-Day Funds
- 2014-15 would end w/ $2.3 billion reserve (incl $1.6 bil in Prop58 resv)
- Proposes new rainy–day fund mechanism

Education
- K–12 schools +$4.5 billion
- Community Colleges +$355 million
- UC and CSU + $142 million each
- Higher Ed Innovation grants +50 million

Also...
- Judiciary and Criminal Justice + $105 million ongoing
- State employees +2% pay $173 million (all funds)

Pay Down “Wall of Debt”
- Accelerate pay down of economic recovery bonds $1.6 billion
- Pay off school and community college deferrals +$6.2 billion
- Repay $1.6 bil in special fund loans

Infrastructure, etc
- Deferred maintenance projects +$815 million (one-time)
- Water Plan +$618 million plan incl groundwater basin protection, local water supplies, flood protection.
- Cap–and–Trade $850 million incl: high–speed rail system +$250 million, low–emission veh progr +$200 million
Proposition 58 (2004)

- Requires 3% of estimated General Fund revenues deposited to Budget Stabilization Account (BSA)
- Deposits continue until BSA reaches $8 billion or 5%.
- Half of BSA deposit repays Economic Recovery Bonds (ERBs) until repaid.
  - Used ‘06-07 & ‘07-08, then emptied.
  - Suspended each year since then.

Governor: replace Prop58

- Annual required deposit - size based on capital gains income tax revenues over 6.5% of annual General Fund revenues.
- Increase size to 10% of estimated General Fund.
- Proposition 98 component: amt counts for current year guarantee - to be used when guarantee drops.
- May pay down budgetary debt instead of depositing to reserve.

Eliminating the “Wall of Debt”

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Deferred payments to schools and community colleges</td>
<td>$10.4</td>
<td>$6.4</td>
<td>$6.1</td>
<td>$0.0</td>
<td>$0.0</td>
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<td>Economic Recovery Bonds</td>
<td>7.1</td>
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<td>3.9</td>
<td>0.0</td>
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<tr>
<td>Loans from Special Funds</td>
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<td>4.9</td>
<td>3.9</td>
<td>2.9</td>
<td>0.0</td>
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<tr>
<td>Unpaid mandated costs to local govts, schools, colleges</td>
<td>4.3</td>
<td>4.9</td>
<td>5.4</td>
<td>5.4</td>
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<tr>
<td>Underfunding of Proposition 98</td>
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<td>2.4</td>
<td>2.4</td>
<td>1.8</td>
<td>0.0</td>
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<tr>
<td>Borrowing from local governments (Proposition 1A)</td>
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<td>1.1</td>
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<td>0.0</td>
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<tr>
<td>Deferred Medi-Cal Costs</td>
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<td>2.0</td>
<td>1.8</td>
<td>1.7</td>
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<tr>
<td>Deferral of state payroll costs from June to July</td>
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<td>0.7</td>
<td>0.8</td>
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<tr>
<td>Deferred payments to CalPERS</td>
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<tr>
<td>Borrowing from transportation funds (Proposition 42)</td>
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<td>0.4</td>
<td>0.2</td>
<td>0.1</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$34.7</strong></td>
<td><strong>$28.2</strong></td>
<td><strong>$24.9</strong></td>
<td><strong>$13.1</strong></td>
<td><strong>$0.0</strong></td>
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</tbody>
</table>

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 2014-15 Budget
Local Government Issues

- Supplemental Frontline Law Enforcement funding continued at $27.5 million (began in 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.

Infrastructure Financing District Proposal

“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.”
- IFD creation, debt issuance subject to 55% voter approval.
- New IFD project areas may overlap former RDA project areas.
- 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.
Pernicious Effects of the VLF-Property Tax Swap of 2004

State General Fund

VLF Backfill
Cities & Counties

Property Tax in Lieu of VLF

Schools

$4.4 b*
The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

<table>
<thead>
<tr>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.0</td>
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<tr>
<td>$5.0</td>
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<td>$10.0</td>
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<td>$15.0</td>
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<tr>
<td>$20.0</td>
</tr>
<tr>
<td>$25.0</td>
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<tr>
<td>$30.0</td>
</tr>
</tbody>
</table>

If incorporated before 2004 swap | After Swap | w/AB1602 VLF patch assumed in incorp process | Actual (after SB89 shift)

- Property Tax
- Sales Tax
- Franchise Fees
- Licenses/Permits
- Other
- VLF
- Special

AB1602 VLF “Bump” to zero over 5 yrs

If incorporated before 2004 swap w/AB1602 VLF patch assumed in incorp process

Actual (after SB89 shift)

- VLF
- Special
- Other
- Sales Tax
- Property Tax

The Lack of VLF Replacement Makes many Annexations Fiscally Unviable

Annexation of Inhabited Area example

<table>
<thead>
<tr>
<th>Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.0</td>
</tr>
<tr>
<td>$0.2</td>
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<tr>
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<tr>
<td>$1.4</td>
</tr>
<tr>
<td>$1.6</td>
</tr>
<tr>
<td>$1.8</td>
</tr>
</tbody>
</table>

If incorporated before 2004 swap | w/AB1602 VLF patch assumed in annex process | Actual (after SB89 shift)

- Property Tax
- Sales Tax
- VLF
- AB1602 Special
- Other

Denied PropTax-in-lieu of VLF that all other areas of city get
Ending the Triple Flip

Can we stick it?

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
$1.4 b

State General Fund
$1.4 b

Schools
The Triple Flip

- 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 for cities & counties at end
  - Equivalent to 1.5 months of your sales tax