Hot Topics ‘n Burning Issues  
A City Finance Update

East Bay Division  
League of California Cities  
May 22, 2014   Pleasant Hill, CA

Michael Coleman  
Fiscal Policy Advisor  
League of California Cities  
Calif Society of Municipal Finance Officers  
coleman@muni1.com   530.758.3952  
CaliforniaCityFinance.com

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

May 22, 2014  ©2014 CaliforniaCityFinance.com
**Governor’s Proposed Budget 2014-15 May Revision**

- **Revenues are up $2.4 billion** (one time – not ongoing...)
  - PIT withholdings, partnerships, dividends
  - re annual bonus payments & 2012 federal tax policy changes

... but higher costs already eat it up

- MediCal enrollment in FY15 to **11.5 million up from 7.9 million**
  - 46% increase – now **30% of population** in MediCal
  - $2.4billion higher costs – but federal gov’t pays half
- Drought $800+ million
- Prop98 $659 million (net)
- CalPERS mortality assumptions, etc. - $1b phased in over 3 yrs
- Courts +$60million to $160 million increase

---

**Governor’s Proposed Budget**

### 2014-15 Governor’s Budget

**General Fund Budget Summary**

($ in millions) Governor’s May Revision 2014

<table>
<thead>
<tr>
<th>Resources</th>
<th>2013-14</th>
<th>2014-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior Year Balance</td>
<td>$2,429</td>
<td>$3,903</td>
</tr>
<tr>
<td>Revenues and Transfers</td>
<td>$102,185</td>
<td>$105,346</td>
</tr>
<tr>
<td>Total Resources Available</td>
<td>$104,614</td>
<td>$109,249</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenditures</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Proposition 98 Expenditures</td>
<td>$57,980</td>
<td>$63,304</td>
</tr>
<tr>
<td>Proposition 98 Expenditures</td>
<td>$42,731</td>
<td>$44,462</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>$100,711</td>
<td>$107,766</td>
</tr>
</tbody>
</table>

| Fund Balance                  | $3,903   | $1,483   |
| Economic Recovery bonds – early repayment (triple flip) | $1,604 |
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 2014-15

- Personal Income Tax: $69,764, 59%
- Sales & Use Tax: $23,823, 20%
- Corporation Tax: $8,910, 8%
- Insurance Tax: $2,382, 2%
- Other/Transfers: $1,597, 1%
- Vehicle License Fee: $2,071 2%
- Realignment Sales Tax: $9,569, 8%

“Local Revenue Fund”
Governor’s Proposed Budget

State General Fund and Realignment Fund Expenditures 2014

California’s Fiscal Outlook

Risks

- **Threat of Recession.** It’s inevitable.
- **Federal Challenges**
  - 2year delay in prison population cap OK
  - Avoided debt ceiling problems
- **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.
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

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

Address CalSTRS retirement liabilities

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

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

Governor’s Proposal for Rainy Day Reserves

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.

New Consensus Proposal
- Annual required deposit - size based on capital gains income tax revenues over 8.0% of annual General Fund revenues plus 1.5% of General Fund Revenues.
- Fill to 10% of General Fund.
- Proposition 98 component: amt counts for current year guarantee - to be used when guarantee drops.
- May use half to pay down debt.

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.

New Consensus Proposal
- Annual required deposit - size based on capital gains income tax revenues over 8.0% of annual General Fund revenues plus 1.5% of General Fund Revenues.
- Fill to 10% of General Fund.
- Proposition 98 component: amt counts for current year guarantee - to be used when guarantee drops.
- May use half to pay down debt.

©2014 CaliforniaCityFinance.com
3 Kinds of Debt

- **Retirement**: providing for employee pensions, healthcare
- **Infrastructure**: borrowing to fund major public facilities
- **Budgetary Debt**: borrowing to fund current services

**State’s Key Liabilities (debts) total over $340 billion**
- But state is addressing $140+ billion of that

**Unpaid debts (liabilities) grow at different rates**
- State should put retirement debt at top of priority list

### Examples of Growth Rates for Key Liabilities

<table>
<thead>
<tr>
<th>Liability</th>
<th>Growth Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalSTRS pension program</td>
<td>7.5%</td>
<td>$73.7</td>
</tr>
<tr>
<td>Retiree health benefits for state employees</td>
<td>4.3%</td>
<td>$64.6</td>
</tr>
<tr>
<td>Special Fund loans to the General Fund</td>
<td>0.7%</td>
<td>$4.5</td>
</tr>
<tr>
<td>Mandate reimbursements to local gov’t</td>
<td>0.3%</td>
<td>$1.9</td>
</tr>
<tr>
<td>Proposition 98 settle-up</td>
<td>0.0%</td>
<td>$1.5</td>
</tr>
</tbody>
</table>

**Unfunded Retirement Obligations**

<table>
<thead>
<tr>
<th>Obligation</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalSTRS pension program</td>
<td>$73.7</td>
</tr>
<tr>
<td>Retiree health benefits for state employees</td>
<td>$64.6</td>
</tr>
<tr>
<td>UC pension &amp; retiree healthcare</td>
<td>$26.3</td>
</tr>
<tr>
<td>Judges’ Retirement System I pension program</td>
<td>$3.3</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$(167.9)</td>
</tr>
</tbody>
</table>

Source: LAO
### Eliminating the “Wall of Debt” Budgetary Debt

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</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>
</tr>
<tr>
<td>Economic Recovery Bonds</td>
<td>7.1</td>
<td>5.2</td>
<td>3.9</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Loans from Special Funds</td>
<td>5.1</td>
<td>4.9</td>
<td>3.9</td>
<td>2.9</td>
<td>0.0</td>
</tr>
<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>
<td>0.0</td>
</tr>
<tr>
<td>Underfunding of Proposition 98</td>
<td>3.0</td>
<td>2.4</td>
<td>2.4</td>
<td>1.8</td>
<td>0.0</td>
</tr>
<tr>
<td>Borrowing from local governments (Proposition 1A)</td>
<td>1.9</td>
<td>1.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Deferred Medi-Cal Costs</td>
<td>1.2</td>
<td>2.0</td>
<td>1.8</td>
<td>1.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Deferral of state payroll costs from June to July</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>0.0</td>
</tr>
<tr>
<td>Deferred payments to CalPERS</td>
<td>0.5</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Borrowing from transportation funds (Proposition 42)</td>
<td>0.4</td>
<td>0.4</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<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>
</tr>
</tbody>
</table>

Source: Governor’s Proposed Budget May Revision

---

### Are Incorporations and Annexations Extinct?

**Pernicious Effects of the VLF-Property Tax Swap of 2004**
The VLF-Property Tax Swap of 2004

- State General Fund
- VLF Backfill
- Cities & Counties
- Property Tax in Lieu of VLF
- Schools

$4.4 b*

* in FY2004-05

The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

- VLF "Bump" Decays to zero over 5 yrs
- Swapped for PropTax in 2004
- VLF AB1602 to zero over 5 yrs
- VLF AB1602 Special
- Denied PropTax in lieu of VLF that all other cities get

Millions

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

If incorporated before 2004 swap

After Swap

w/AB1602 VLF patch assumed in incorp process

Actual (after SB89 shift)
The Lack of VLF Replacement Makes many Annexations Fiscally Unviable

- Over-reliance on land development revenue
- Over-reliance on redevelopment revenues
- Risky financing schemes
- Unsustainable Decline in Core Revenues
- Toxic relationships
- Fear & Denial
- Ceding of management and policy choices to others

Bad Brew in Troubled Cities
Diagnosing Municipal Fiscal Health

- Published data are not complete or timely.
- Do we know how to assess those facts?
- Comparisons are often false and tell us nothing about solvency.

Difficulties in Assessing Municipal Financial Health

- Requires analysis, forecasting, context, legal ... it's not just an accounting or statistical exercise
- Looking forward to sustainability
  - history doesn't tell you enough about the future
California Municipal Financial Health Diagnostic:

- Get to the **primary indicators**
  - useful & essential
  - Leave out extraneous / secondary
  - Add in overlooked & underappreciated factors
- Drill down to the **real** numbers
- Allow for nuance / clarification / differences
  - Reduce invalid conclusions and comparisons
- Constructive, thoughtful approach