Hot Topics ‘n Burning Issues
A City Finance Update

2014 Planning Commissioners Academy
March 17, 2014   Burlingame, CA

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The California Local Government Finance Almanac

California was hit especially hard
- Housing: construction / real estate
- Exports: goods / tourism / licenses
- Business Spending—especially IT

The Economy is Recovering
But Municipal Budgets Remain in Peril

Local Budgets
- Taxable sales up but regional variation—serious allocation issues
- Property tax growth is finally up—still flat in some areas
- Short term band-aids are gone
- Redevelopment dissolution could not have come at a worse time. Not just the revenue loss … uncertainty & workload.
- Pension/OPEB problems are huge and cannot be ignored
  2012 reform package is helpful … but more is needed

What will the State Legislature do? Fix? Shift?
- Staff & councils are overwhelmed
- Some key players believe the recovery will solve it (wrong!)
Local revenue risk and uncertainty
- state actions
- local conditions

Tax structures out of step with changing society:
- sales tax,
- hotel tax,
- gas tax,
- utility user tax

Fragmentation of local finance and governance among overlapping governments

Disconnect between service costs & revenues in urban development.
“Fiscalization of Land Use”

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

Fear & Denial
Toxic relationships
## Governor’s Proposed Budget

### 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><strong>Resources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior Year Balance</td>
<td>$2,528</td>
<td>$4,212</td>
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<tr>
<td>Revenues and Transfers</td>
<td>$100,147</td>
<td>$104,503</td>
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<tr>
<td>Total Resources Available</td>
<td>$102,675</td>
<td>$108,715</td>
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<tr>
<td><strong>Expenditures</strong></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><strong>Fund Balance</strong></td>
<td>$4,212</td>
<td>$1,922</td>
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<tr>
<td>Budget Stabilization Account / &quot;Rainy Day Fund&quot;</td>
<td>$1,591</td>
<td></td>
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</tbody>
</table>
**Governor’s Proposed Budget**

**State General Fund and Realignment Fund Revenue**

- **Personal Income Tax**: $69,764, 59%
- **Corporation Tax**: $9,682, 8%
- **Insurance Tax**: $2,297, 2%
- **Other/Transfers**: $1,281, 1%
- **Vehicle License Fee**: $2,071, 2%
- **Realignment Sales Tax**: $9,569, 8%
- **Sales & Use Tax**: $24,071, 20%
- **Legisl Judicial Exec**: $2,844, 0%
- **BusnConsSvsHsg**: $745, 1%
- **Transporation**: $212, 0%
- **Resources & Environment**: $2,229, 2%
- **Health & Human Svcs**: $28,793, 24%
- **Mental Health, Support Svcs**: $9,330, 8%
- **Law Enforcement, Trial Court**: $2,296, 2%
- **K-12 Education**: $45,251, 38%
- **General Govt**: $3,191, 3%
- **ERB Payment**: $1,591, 1%
- **Higher Education**: $12,377, 11%
- **Corrections**: $9,560, 8%

**State General Fund and Realignment Fund Expenditures**

- **Health & Human Svcs**: $28,793, 24%
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March 27, 2014
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>
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</thead>
<tbody>
<tr>
<td>Personal Income Tax</td>
<td>$64,287</td>
<td>$69,764</td>
<td>$5,477</td>
<td>8.5%</td>
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<tr>
<td>Sales and Use Tax</td>
<td>22,920</td>
<td>24,071</td>
<td>1,151</td>
<td>5.0%</td>
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<tr>
<td>Corporation Tax</td>
<td>7,971</td>
<td>8,682</td>
<td>711</td>
<td>8.9%</td>
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<tr>
<td>Insurance Tax</td>
<td>2,143</td>
<td>2,297</td>
<td>154</td>
<td>7.2%</td>
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<tr>
<td>Alcoholic Beverage Taxes and Fees</td>
<td>350</td>
<td>357</td>
<td>7</td>
<td>2.0%</td>
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<tr>
<td>Cigarette Tax</td>
<td>89</td>
<td>86</td>
<td>-3</td>
<td>-3.4%</td>
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<tr>
<td>Motor Vehicle Fees</td>
<td>20</td>
<td>20</td>
<td>0</td>
<td>0.0%</td>
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<tr>
<td>Other</td>
<td>2,367</td>
<td>817</td>
<td>-1,550</td>
<td>-65.5%</td>
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<tr>
<td><strong>Subtotal</strong></td>
<td>$100,147</td>
<td>$106,094</td>
<td>$5,947</td>
<td>5.9%</td>
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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

![Capital Gains Chart](chart.png)
LAO’s Hypothetical Recession

Operating Deficits Return Under Hypothetical Recession Scenario

General Fund and Education Protection Account Combined (In Billions)

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.

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”

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<thead>
<tr>
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<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>
<td>5.2</td>
<td>3.9</td>
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<td>Loans from Special Funds</td>
<td>5.1</td>
<td>4.9</td>
<td>3.9</td>
<td>2.9</td>
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<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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<td>Underfunding of Proposition 98</td>
<td>3.0</td>
<td>2.4</td>
<td>2.4</td>
<td>1.8</td>
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<td>Borrowing from local governments (Proposition 1A)</td>
<td>1.9</td>
<td>1.1</td>
<td>0.0</td>
<td>0.0</td>
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<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>
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<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>
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<tr>
<td>Deferred payments to CalPERS</td>
<td>0.5</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
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<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>
</tbody>
</table>

Total: $34.7 $28.2 $24.9 $13.1 $0.0

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

City/County mandate cost repayment:
- 2015-16 $748m
- 2016-17 $152m
Are Incorporations and Annexations Extinct?  
Pernicious Effects of the VLF-Property Tax Swap of 2004

The VLF-Property Tax Swap of 2004

- VLF Backfill
- Cities & Counties
- Property Tax in Lieu of VLF

$4.4 b^*$

State General Fund

$4.4 b$

$4.4 b$

Schools

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

City of Jurupa Valley General Fund

- VLF: "Bump" Declines to zero over 5 yrs
- AB1602 to zero over 5 yrs
- Sales Tax
- Franchise Fees
- Licenses/Permits
- Property Tax
- Other

Swapped for Prop Tax in 2004

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

Annexation of Inhabited Area example

- VLF: Swapped for Prop Tax in 2004
- AB1602 Special
- Sales Tax
- Property Tax

if incorporated before 2004 swap

w/AB1602 VLF patch (assumed in annex process)

Actual (after SB89 shift)
More info...

- [www.CaliforniaCityFinance.com](http://www.CaliforniaCityFinance.com)
  the California Local Government Finance Almanac

  $20 (see CaliforniaCityFinance.com)

  $90

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