



BUDGET ACTION BULLETIN

CALIFORNIA STATE ASSOCIATION OF COUNTIES

2010-11 State Budget Week of March 22, 2010

March 23, 2010

TO: CSAC Board of Directors
County Administrative Officers
CSAC Corporate Associates

FROM: Paul McIntosh, CSAC Executive Director
Jim Wiltshire, CSAC Deputy Executive Director
Jean Kinney Hurst, Legislative Representative

RE: **Budget Action Bulletin #3**

Last night, Governor Schwarzenegger approved the final element of the midyear budget package when he signed ABX8 6 and ABX8 9 as part of an agreement with legislative Democrats. With the Eighth Extraordinary Session now closed, this concludes action on the budget until the May Revision. The following is a list of all bills included in the Eighth Extraordinary Session:

Bill Number	Topic	Action
ABX8 1	Current year budget	Signed
ABX8 2	2010-11 budget reductions	Vetoed
ABX8 3	Fines	Signed
SBX8 4	Social services	Signed
ABX8 5	Cash management	Signed
ABX8 6	Gas tax swap	Signed
ABX8 7	Beverage Container Recycling Fund	Signed
ABX8 9	Transportation finance	Signed
ABX8 10	Tribal gaming	Signed
ABX8 11	Transportation bonds	Signed
ABX8 12	Port grants	Signed
ABX8 14	Cash management clean-up	Signed

In a letter to legislative leaders last week, the Governor vowed to veto the gas tax swap as the Legislature did not pass the “job creation” measures the Governor had requested. Yesterday, the Legislature approved two of the three measures requested by the

Governor: AB 183, by Assembly Member Caballero, which offers a \$10,000 first-time homebuyer tax credit, and SB 71, by Senator Alex Padilla, which provides a sales tax exclusion for companies that purchase green-technology manufacturing equipment. The Legislature also approved SB 70, by the Senate Budget and Fiscal Review Committee, which provides clean-up to the gas tax swap package to ensure that railroads would not be subject to a tax increase. Please see the remainder of this Bulletin for more information on these bills.

This Budget Action Bulletin wraps up activities in the Eighth Extraordinary Session. Please see our previous [Budget Action Bulletins](#) for specific information on the various components of the midyear budget package or contact CSAC staff with your questions.

ADMINISTRATION OF JUSTICE

As described in previous budget updates, two measures in the Eighth Extraordinary Session contained provisions relating to corrections budget issues: ABX8 2 and ABX8 3. On February 22, the Legislature sent both bills – which together contained state savings of approximately \$1 billion in the public safety arena – to the Governor for his review and action.

On March 8, the Governor vetoed ABX8 2, which contained all of the corrections reductions. In his veto message, the Governor explained that he did not sign ABX8 2 because “it does not actually implement spending reductions and make progress to close the budget gap.” He also stated that the savings assumptions were unrealistic, citing the example of the commutation of sentences for undocumented criminals. The specific elements of ABX8 2 related to public safety were as follows:

- \$182 million reduction to the budget for the California Department of Corrections and Rehabilitation (CDCR) associated with the commutation of sentences for undocumented state prison inmates. Counties will recall the Governor possesses the constitutional authority to commute sentences; undocumented inmates whose sentences are commuted would be transferred to federal authorities for deportation. *(Note that the Administration has already informed the Legislature that the Governor — following the department’s review of the undocumented immigrant prison population last fall — now believes it is possible to commute the sentences of only 860 undocumented inmates, reducing the expected savings associated with this item to \$19 million.)*
- \$811 million cut to CDCR’s budget related to the Federal Healthcare Receiver achieved by bringing per-inmate medical costs in line with that of the State of New York. (New York, with per-inmate medical costs of \$5,757, has the second highest medical spending behind California’s average cost of \$11,627.)

- \$45 million reduction to the Department of Justice’s (DOJ) budget, with an expectation that the reduction would be offset by a fee increase contained in ABX8 3 (discussed below).
- \$48 million unallocated reduction to the Division of Juvenile Justice (DJJ).

On March 8, the Governor signed into law ABX8 3, which, among other provisions, contains a directive to increase the existing penalty assessment (authorized in Government Code Section 76104.7) on criminal offenses from \$1 to \$3 for purposes of generating revenue for state forensic lab services. Note that this increase was intended to offset a concurrent cut (contained in ABX8 2 and, therefore, not enacted) of \$45 million to DOJ.

Counties should be aware that ABX8 3 (a non-urgency measure) goes into effect, pursuant to provisions governing extraordinary legislative sessions, 91 days after the session’s adjournment. The Legislature adjourned the Eighth Extraordinary Session on March 11; accordingly, the provisions of ABX8 3 become effective on June 10, 2010.

GOVERNMENT FINANCE AND OPERATIONS

Tax Relief Measures. As mentioned previously, the Legislature approved as part of an agreement with the Governor two “job creation” measures yesterday.

SB 71, by Senators Alex Padilla, Elaine Alquist, and Tony Strickland, and co-authored by 51 Assembly Members representing both parties, expands the authority of a state financing authority to exclude green manufacturing equipment from sales and use taxes.

The California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) currently provides several kinds of financial assistance, including sales tax breaks, to companies and public agencies for "advanced transportation systems" or to buy equipment that uses alternative energy sources. SB 71 would allow CAEATFA to grant sales and use tax exclusions for equipment to manufacture advanced transportation systems or alternative energy source products.

The committee analysis of the bill roughly estimates that the local revenue losses due to the sales and use tax exclusion would be approximately \$6.5 million per year. However, it also notes the Administration's claim that, absent this program, the projects CAEATFA approves wouldn't have occurred.

CAEATFA is to examine the following criteria when decided whether to approve a particular project:

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- The extent to which it develops or expands manufacturing facilities in California.
- The extent to which the benefit to the state exceeds the benefit to the company of the tax break.
- The extent to which it creates new, permanent jobs in the state.
- The extent to which the project reduces pollution or energy consumption.
- The extent of unemployment around the project's location.

Under the terms of the bill, CAEATFA has to notify the Legislature when the tax breaks exceed \$100 million, then wait 20 days before approving more of them. The Legislative Analyst's Office would have to report on the program's effectiveness by the end of 2018, and the bill's provisions would sunset at the end of 2020.

AB 183, by Assembly Member Anna Caballero, provides a \$10,000 state tax credit for first-time homebuyers and for purchasers of new homes. (Counties will recall a tax credit in the 2009-10 budget that offered a similar tax credit for purchase of new homes that was wildly popular.) Credits are capped at \$100 million each for first-time homebuyers and for purchase of new homes, resulting in a General Fund cost of \$200 million.

Cash Management. The Governor also signed ABX8 14, the cash management clean-up bill. Counties will recall that this measure includes additional requirements that a county that chooses to use Proposition 1B funds during the deferral of Highway Users Tax Account (HUTA) funds must repay their Proposition 1B account with interest.

HOUSING, LAND USE AND TRANSPORTATION

Governor Signs Transportation Tax Swap Legislation. Transportation has been the focus of much debate between the Governor and the Legislature over the past few months as efforts to develop an alternative to the Governor's transportation tax swap proposal contained in the January 2010-11 state budget were successful with his signature on a two-bill package late Monday night. On March 4, the Legislature sent an alternative package (AB8X 6 and AB8X 9) to the Governor; however, his initial reaction was to express his intent to veto both measures unless further revisions to the deal were made. Over the past week the Legislature has worked on clean-up language to the alternative proposal to garner agreement from the Governor. With the passage of three measures last night - SB 70, a technical clean-up to the tax swap, SB 71, tax exemptions for clean-technology manufacturing equipment and AB 183, an extension of the first-time homebuyer tax credit - the Governor signed the transportation bills into law.

CSAC supported the Legislature's alternative tax swap, which will partially restore transit funding, hold harmless local streets and roads funding, increase funding for the

preservation and safety of the state highway system, and provide an average of \$1 billion a year in general fund (GF) relief into the future.

Due to the many changes to the various proposals we have been tracking over the past few months, CSAC wanted to provide the following overview of what is contained in the final transportation tax swap bill package.

Local Street and Roads and State Highways. The final proposal signed by the Governor eliminates the sales tax on gasoline—the source of both Proposition 42 and spillover funds—and increases the excise tax on gasoline by 17.3 cents, indexed to keep pace with what the sales tax on gasoline would generate in a given fiscal year (FY). This is a change from the Governor’s proposal and is necessary to achieve true revenue neutrality.

This change holds local streets and roads (LSR) harmless under the new law as cities and counties are expected to receive new gas taxes equivalent to what would have been generated by Prop 42.

The funding scenario in FY 2010-11 is different than in FY 2011-12 and into the future. In FY 2010-11, the 17.3-cent excise tax increase will generate \$2.52 billion and be distributed as follows:

- \$603 million general fund transportation bond debt service
- \$629 million State Transportation Improvement Program (STIP)
- \$629 million LSR
- \$650 million in additional Article XIX transportation revenues for future appropriations by the Legislature

In FY 2011-12 and into the future, the 17.3-cent excise tax increase will generate various amounts as it is adjusted to keep pace with what the sales tax on fuels would have generated. In FY 2011-12 it is estimated to generate \$2.4 billion and will provide the following:

- \$727 million to general fund transportation bond debt service*
- 44 percent for the STIP
- 44 percent for LSR
- 12 percent for the State Highway Operation and Protection Program

*This also changes on an annual basis to keep pace with increasing state GF debt service obligations estimated to peak at \$1.25 billion in 2017.

CSAC estimates this as \$780 million in LSR funding or \$390 million for counties in FY 2011-12 from the increased excise tax, meant as replacement revenue for the loss of Proposition 42. Again, the transportation tax swap should remain revenue neutral for local streets and roads funding.

Transit. Beginning in 2011-12, the final proposal increases the sales tax on diesel fuel by 1.75 percent (five percent to 6.75 percent) and decreases the excise tax on diesel by 4.4 cents in 2011-12 (from 18 to 13.6 cents). Further, it provides that 75 percent of revenue from the diesel sales tax be directed to transit operators beginning in 2011-12 (roughly \$350 million per year). The amount available for intercity rail and other state purposes will grow, via receipt of 25 percent of the state sales tax on gas and most of the non-Article XIX transportation funds (about \$72 million per year).

Transit operators would also receive a \$400 million one time appropriation for the remainder of FY 2009-10 and FY 2010-11.

Under current law, certain fuel consumers are exempt from excise taxes, others pay a reduced excise rate, and others are exempt from sales tax. Therefore, SB 70 was passed as clean-up to AB 8X 6 to ensure that the special fuel users would not see any negative tax impact from the gas tax swap.

Transportation Tax Swap Effects on Counties. While the transportation tax swap proposal significantly changes the architecture of transportation funding in the state, local streets and roads remain whole under the new funding system.

However, the transportation tax swap package, by eliminating the sales tax on gasoline and Proposition 42, removes the constitutional protections afforded to about half of the current local road funding for counties. While it has been suggested that this action will in essence “divorce” transportation revenues from the GF, only time will tell whether these monies will be less vulnerable to “takings” into the future and truly remain outside of the State’s budget battles.

Transportation Tax Swap Effects on Transit. The transportation tax swap proposal will provide local transit operators with a State Transit Assistance (STA) program of nearly \$350 million beginning in FY 11-12 and gradually increase in the out years.

The California Transit Association also reports that the STA program is projected to be \$348 million in 2011-12 and 2012-13, due to the exemption from the new diesel fuel rate and is still projected to exceed \$350 million per year, starting in 2013-14.

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If you would like to receive the Budget Action Bulletin electronically, please e-mail Amanda Yang, CSAC Legislative Assistant, at ayang@counties.org. We're happy to accommodate you!