Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair

Senator Janet Nguyen
Senator Richard Pan

Wednesday, May 20, 2015
10:00 a.m.
Rose Ann Vuich Hearing Room (2040)

Consultant: Mark Ibele

May Revision and Open Issues
Agenda—Part A

Vote-Only Calendar

Discussion / Vote Calendar

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Vote-Only Calendar

Control Section 12.00 State Appropriations Limit

1) **Revised State Appropriations Limit (Governor's Budget and May Revision).** The Administration requests that the budget bill be amended to reflect the updated change in the State Appropriations Limit (SAL). The revised limit of $94.042 billion is the result of applying the growth factor of 4.55 percent. The revised 2015-16 limit is $899 million above the $93.143 billion estimate in January.

   Staff Comment: Staff has no concerns with this technical change.

   Staff Recommendation: Approve the revision to the State Appropriations Limit.

   Vote:

Control Section 6.10 Deferred Maintenance

2) **Funding for Deferred Maintenance (Budget Bill Language).** Budget Control section 6.10 gives the Department of Finance the authority to allocate $125 million across a broad spectrum of departments. Revised budget bill language, providing for greater legislative input, was approved in Subcommittee No. 4 at its May 7 hearing. Subcommittee No. 1 has determined that the amount established for state special schools ($3.0 million) should fall within the Proposition 98 guarantee.

Staff Comment: Absorbing the deferred maintenance costs on the Proposition 98 side of the budget would free-up additional resources for addressing non-Proposition 98 obligations. The differed maintenance for state special school is anticipated to be addressed within the education trailer bill.

Staff Recommendation: Amend Control Section 6.10 approved on May 7 to exclude $3.0 million for state special schools, and reduce total amount in this provisional language to $122.0 million. The revised budget bill language, reflecting proposed Subcommittee No. 1 action, would be:

(a) Notwithstanding any other provision of law, the Director of the Department of Finance may allocate $~~125~~ $122 million General Fund to the departments in the amounts identified below for deferred maintenance projects:
University of California 25,000,000
California State University 25,000,000
Department of Parks and Recreation 20,000,000
Department of Corrections and Rehabilitation 15,000,000
Department of Food and Agriculture 9,000,000
Department of State Hospitals 7,000,000
Department of Developmental Services 7,000,000
Department of General Services 5,000,000
Office of Emergency Services 3,000,000
~~State Special Schools 3,000,000~~
Department of Forestry and Fire Protection 2,000,000
California Military Department 2,000,000
Department of Veterans Affairs 2,000,000

(b) ~~Prior to any allocation of funds, the entities identified above shall provide to the Department of Finance a list of deferred maintenance projects that the funding shall be allocated for.~~ A department shall only expend the funding identified in subsection (a) on deferred maintenance projects included in the Supplemental Report of the 2015–16 Budget Package.

~~The Department of Finance shall review and provide the approved list to the Chairperson of the Joint Legislative Budget Committee 30 days prior to allocating any funds. The Department of Finance shall provide a schedule to the Controller providing for the allocation.~~

(c) A department may ~~An entity seeking to make~~ a change ~~to~~ the ~~approved~~ list included in the Supplemental Report of the 2015–16 Budget Package. ~~after the funds have been~~

~~allocated~~ <u>Prior to making a change to the list, a department</u> shall obtain the approval of the Director of Finance and the Director of Finance shall notify the Chairperson of the Joint Legislative Budget Committee 30 days before the change is approved. <u>The notification to the Joint Legislative Budget Committee shall identify the projects proposed to be removed and added, the cost of those projects, and the reasons for the proposed changes.</u>

(d) Of the amount identified for the Department of Food and Agriculture, $7.0 million is for the Network of California Fairs.

(e) The amounts allocated pursuant to subdivision (a) shall be available for encumbrance or expenditure until June 30, 2017.

Vote:

0860 Board of Equalization

3) **Cigarette Tax and Licensing Program (Budget Bill Language).** California imposes excise taxes on cigarettes and other tobacco products, such as cigars and chewing tobacco. Most revenue raised by the tax goes to special funds with a minor amount going to the state General Fund. The state also licenses sellers of tobacco products. The BOE administers the tax and licensing programs. Recently, concerns have been raised—largely by programs and beneficiaries that receive the tax revenues—regarding program costs. In particular, while licensing fees pay for some of the licensing program costs, most of the costs are borne by tax revenues—which results in a decrease in the amount benefiting the actual programs. Currently, tax revenues pay for about 80 percent of the licensing program costs. In response to concerns, the Legislature approved supplemental reporting language in 2014, requiring BOE to submit a report to the Legislature on the costs of the program and alternative funding approaches. The BOE's report on funding options for the licensing program describes eleven various options. In its review of the BOE report, the LAO observed and recommended: (1) excise tax revenues should be used for tax administration costs and not for licensing program costs; (2) amounts and frequency of payment for licensing fees should increase such that they are sufficient to pay licensing program costs. LAO also recommends that the Legislature adopt budget bill language that would require BOE and the Department of Justice to report on an approach to an electronic filing system.

Staff Comments: The support of the licensing program by tax revenues appears to result in subsidizing activities that—while related to the tax—are not directly related to its administration. Staff recommends the following budget bill language to address these issues:

> *By February 1, 2016, the California Department of Justice (DOJ) shall submit a report to the fiscal committees of the Legislature describing options for reducing the administrative costs of the State Board of Equalization's (BOE's) and DOJ's cigarette and tobacco programs while maintaining the effectiveness of these programs. Each option shall include a timeline for implementation. Each option shall also include estimates of the effects of implementing that option on BOE's and DOJ's administrative costs. At least one option shall be designed to increase the rate of electronic filing of various forms related to these programs. The BOE and other state agencies shall provide information requested by DOJ in connection with this reporting requirement.*

Staff Recommendation: Adopt proposed budget bill language.

Vote:

0950 State Treasurer's Office

4) Strategic Information Technology Initiatives (Spring Finance Letter). The State Treasurer's Office (STO) is improving the accessibility to services, data and information provided, as well as to improve and upgrade its information technology (IT) capabilities. The proposal will realign funding in accordance with benefits received and would be consistent with the Treasurer's strategic plan. The proposal from the STO, approved by the Administration, calls for upgrading and improving several components of the STO IT technical services. For the entire proposal, 11 new positions in three areas would be established, with additional required resources of $1.4 million (reimbursements and special funds). The positions are: Five additional positions for the Data and Government Transparency Unit, to redesign and expand the STO's public website and interfaces with various databases; three additional positions for the Project Management Office, to establish a permanent presence at the STO, in response to a request from the California Department of Technology (CalTech); three positions for Technical Support Services, to address additional workload from the prior Administration, and manage the conversion from obsolete and dated systems.

Staff Comments: This item was heard in subcommittee on April 23, 2015. The subcommittee approved the additional positions for the Project management Office and Technical Support Services (items 2 and 3, above), and held open the Data and Government Transparency Unit positions. Staff is in general agreement with LAO recommendation regarding the Data and Government Transparency Unit, in that this proposal could benefit from additional germination allowing for refinements and provide for an incremental approach. Some preliminary scoping of this area could be accomplished prior to the formulation of a follow-up proposal (presumably as part of the January 2016 budget), and thus, a limited amount of resources could be appropriate at this time.

Staff Recommendation: Staff recommends approving one initial position for Data and Government Transparency Unit. Staff also recommends rescinding prior approving Technical and Support Services positions and approving these as limited-term.

Vote:

0110 and 0120 State Legislature

5) **Legislative Budget (Constitutional Adjustment).** The Legislature's budget for 2015-16 was proposed in January to be $116.2 million for the Senate and $153.2 million for the Assembly. Under the terms of Proposition 140, the growth in the Legislature's budget is constitutionally limited to the growth in the state's appropriation limit (SAL). The year-to-year SAL increase is calculated to be 4.55 percent in the Governor's May Revision. Applying this to the legislative budget would result in funding of $121.536 million for the Senate and $160.139 million for the Assembly.

   Staff Comment: The Senate's budget was held constant from 2008-09 to 2009-10, reduced by a negative SAL of -1.77 percent in 2010-11, received no increase in the subsequent two years (2011-12 and 2012-13), then received increases of 5.8 percent in 2013-14 and 0.48 percent in 2014-15. Legislative increases were forgone because of the state's budget constraints during the previous recession. The combined spending by the Senate and the Assembly is now well below the State Appropriations Limit. Funds from the Senate and Assembly appropriations are also used to fund the Legislative Analyst's Office.

   Staff Recommendation. Staff recommends that the Legislature's (Senate and Assembly) budget be adjusted as provided in the State Constitution, resulting in a total increase for the Legislature of $12.3 million.

   Vote:

9210 Local Government Financing

6) **Nevada County Trial Costs (Governor's Budget).** The Governor's budget proposes to provide $393,000 to the Nevada County Public Defender's Office for extraordinary defense costs associated with State of California v. Lester et al proceedings, and budget bill language. The amount appropriated would be available through June 30, 2019, upon approval by the State Controller's Office. The state has in the past provided assistance to county for extraordinary expenses associated with homicide trial. In this case, there are exceptional expenses associated with the Public Defender's Office assigned to the case. The county is obligated to provide legal assistance to the defendants.

   Staff Comments: This item was heard in subcommittee on April 9, 2015, and held open, pending additional information on what constitutes authorized expenses as noted in the proposed budget bill language. The DOF has indicated that this is covered by Government Code section 15201.

   > *As used in this chapter, **"costs incurred by the county" means all costs, except normal salaries and expenses, incurred by the county in bringing to trial or trials, including the trial or trials** of, a person or persons for the offense of homicide, including costs, except normal salaries and expenses, incurred by the district attorney in investigation and prosecution, by the sheriff in investigation, **by the public defender or court-appointed attorney or attorneys in investigation and defense,** and all other costs, except normal salaries and expenses, incurred by the county in connection with bringing the person or persons to trial including the trial itself, which include extraordinary expenses for such services as witness fees and expenses, court-appointed expert witness fees and expenses, reporter fees, and costs in preparing transcripts. Trial costs shall also include all pre-trials, hearings, and post-conviction proceedings, if any.*

   Staff Recommendation: Approve as budgeted.

   Vote:

7) **Subventions to Amador, San Mateo and Alpine Counties (Governor's Budget and May Revision).** The Administration now proposes a General Fund subvention of $5.8 million to backfill Amador, San Mateo and Alpine counties due to circumstances that reduced property tax directed to those county governments, and cities within those counties, in 2012-13, and budget bill language. These circumstances also occurred in these counties in the prior year, and the state provided a subvention. The revenue losses will likely continue to some degree in the future, but the Administration indicates its current proposal is of a one-time nature. The estimated amounts are: $2.1 million to Amador, $3.5 million to San Mateo and $198,000 to Alpine.

Legislation enacted early in the Schwarzenegger Administration shifted local property tax from schools to cities and counties to accommodate two state fiscal initiatives—the Triple Flip and the Vehicle License Fee (VLF) Swap. Schools were then backfilled with state funds for each of these initiatives. Overall, the fiscal changes resulted in a large net revenue gain for cities and counties as the replacement revenue streams have grown faster than the relinquished revenue streams. However, unique circumstances reportedly reversed this outcome in 2010-11 for Amador County and in 2011-12 and 2012-13 for Alpine, Amador, and San Mateo counties. The backfill for the Triple Flip and the VLF Swap must originate from property taxes either shifted from the Education Revenue Augmentation Fund (ERAF) or from non-basic aid K-12 and community college districts (but not from so-called 'basic aid' schools). This funding mechanism stopped fully working for Amador County reportedly in 2010-11 due to all the schools in the county becoming basic aid schools. Basic aid schools receive sufficient local property tax to fully fund the per-student amounts required by the Proposition 98 guarantee, and therefore, the state's funding is minimal. Due to this basic aid situation, current law will not provide backfill for such schools for any property tax shifted to cities and counties. County auditors have reportedly reduced or discontinued the shift of property tax from schools to those cities and counties.

Staff Comments: This subcommittee heard this issue on April 9, and held it open, pending May Revision revenue data. The DOF provided a May Revision request that this item be eliminated (and have the appropriation included as part of a local government trailer bill), but this was subsequently determined to be an error. Thus, the revised revision of this request, as communicated by DOF staff, calls for $5.8 million, allocated to the three counties.

Staff Recommendation: Approve the Governor's budget request and budget bill language, as revised subsequent to the May Revision. Reject the May Revision finance letter.

Vote:

9620 Cash Management and Budgetary Loans

8) **Changes in Interest payments on Short-Term and Budgetary Borrowing (Governor's Budget and May Revision).** The Administration has requested this item be decreased by $5.0 million from $20.0 million to $15.0 million due to reduced internal cashflow borrowing needs. In addition, external borrowing costs are to be reduced from $20.0 million to $0.0 since no external borrowing will be required in the budget year. Finally, the revised budgetary loan repayment schedule is adopted and interest cost on budgetary borrowing should be increased by $20.1 million to reflect the revision to the budgetary loan repayment schedule.

Staff Recommendation: Approve the May Revision request.

Vote:

9625 Interest Payments to the Federal Government

9) **Reduction in Interest Payments to the Federal Government (May Revision).** The Administration has requested that this item be decreased by $7.0 million (from $10.0 million to $3.0 million) as a result of lower projected interest payments to the federal government. Interest rates used to calculate interest owed remain low.

Staff Recommendation: Approve the May Revision request.

Vote:

0000 Historic State Capitol Commission

10) **New Budget Item for Support of Capitol Maintenance (Legislative Proposal).** To provide a budget vehicle to allow for contributions to support the maintenance and upkeep to the Capitol building and surrounding property. The item would contain no appropriation at this time. Administration of the fund and custodial duties are to be determined through direction of regulation from Department of Finance.

Item	*Amount*
XXXX-001-0001 - For support of the Historic State Capitol Commission	
Schedule:	
(1) XX-Historic State Capitol Commission	*700,000*
(2) Reimbursements	*-700,000*
Provisions:	

> *1. Notwithstanding any other provision of law, all moneys that are received by the Historic State Capitol Commission as donations or financial contributions from any source, public or private, or as revenue from any concession operated in the State Capitol, pursuant to subdivision (f) of Section 9149.7 or Section 9149.12 of the Government Code, that have not been taken into consideration in the schedule of this item or are in excess of the amount so taken into consideration are to be credited to this item and are hereby appropriated in augmentation of this item for the same programs and purposes for which appropriations for this item have been made by this act.*

Staff Recommendation: Approve the new budget item, with administration of the fund and custodial responsibilities to be determined through direction or regulation by Department of Finance.

Vote:

Discussion / Vote Calendar

0590 Governor's Office of Business and Economic Development

Issue 1: California Small Business Development Center (May Revision)

Governor's Proposal: The Governor's Office of Business and Economic Development (GO-Biz) has requested one time appropriation of $2.0 million (General Fund) as a partial match of federal funds to support the Small Business Development Center (SBDC) network.

Background: The SBDC provides training to small business owners, including in the areas of start-up assistance, planning for growth and expansion, technology and innovation, and access to capital. The funds will be used for competitive grants to the SBDC offices, and require quarterly reports on results. After receiving no funding from the General Fund from 2004 through 2010, the SBDC program received a one-time $6.0 million in 2011 and then $2.0 million in General Fund in 2014, (no General Fund was received in 2012 or 2013).

Staff Comments: The proposal will help with SBDC funding, but there should be additional efforts to stabilize support for the program, especially given the erratic nature of state support. In addition, the proposal will only allow for a partial draw on available federal funds, unless additional resources can be accessed. Up to 50 percent of the required match may be in-kind, as opposed to cash match. Thus, the SBDC program must generate an additional $4.4 million to maximizing the federal draw-down.

Staff Recommendation: Approve the May Revision request.

Vote:

0971 California Alternative Energy and Advanced Transportation Financing Authority

Issue 1: Extension of Renewable Resource Trust Fund Repayment Date (May Revision).

Governor's Proposal: The Administration has requested budget bill language that would allow for an extended repayment date for a loan to California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) from the Renewable Resource Truest Fund (RRTF). The loan repayment extension is currently due June 30, 2016 and the extension would provide for repayment in stages over three years with full repayment by June 30, 2019.

The proposed budget bill language would read:

> *Notwithstanding any other provision of law, including the scheduled repayment date of June 30, 2016, pursuant to Provision 2 of Item 0971-001-0528 of the Budget Act of 2013 (Chapter 20, Statutes of 2013), the $2,409,000 loan from the Renewable Resource Trust Fund to the California Alternative Energy and Advanced Transportation Authority Fund shall be repaid to the Renewable Resource Trust Fund as follows: $803,000 by June 30, 2017, $803,000 by June 30, 2018, with the remaining balance, including applicable interest calculated at the rate earned by the Pooled Money Investment Account at the time of the transfer to the California Alternative Energy and Advanced Transportation Authority Fund, to be repaid by June 30, 2019. Any fee revenue received pursuant to the program established by Chapter 10 of the Statutes of 2010 may be used to support the program as long as this use does not interfere with the repayment of the loan, which is due not later than June 30, 2019.*

Background: CAEATFA received a $2.4 million loan from RRTF as part of the 2010 Budget Act. The purpose of the loan was to cover start-up costs of the sales and use tax exclusion program (STEP). The STEP was designed and anticipated to be self-sustaining by covering its expenses through application and administrative fees charged to applicants. CAEATFA has experienced erratic application volume and program activity for STEP, due to the economic recession, localized industry trends, and the (competing) sales and use tax exemption for manufacturers.

Staff Comments: The proposal provided no information on the effect of the loan extension on the condition or future viability of the RRTF.

Staff Recommendation: Reject the proposed loan repayment delay.

Vote:

0950 State Treasurer's Office

Issue 1: Debt Management System (May Revision)

Governor's Proposal: The Administration proposes to continue funding for the replacement of the State Treasurer's Office (STO) debt management system. The $1.4 million (reimbursements) requested consists of $302,000 for a project management support vendor, $200,000 for Department of Technology (CalTech) procurement assistance, $97,000 for the procurement assistance vendor, $140,000 for independent verification and validation services, $113,000 for CalTech project oversight, and $530,000 of continued funding for positions (data processing manager, senior programmer analyst, system software specialist, and treasury program manager. The STO has changed the procurement strategy for the DMS II Project from what was as previously submitted in SPR1, based on vendor feedback provided to the STO from the pre-solicitation RFP and resulting analysis. Subsequent to the submission of the May Revision request, staff was notified of requested change in the procurement strategy. In 2013, had STO determined that replacing the existing debt management system with a solution-based procurement using a systems integrator was in the State's best interest, due to available expertise staffing. However, STO subsequently determined based on potential vendor feedback learned it would be very difficult to completely satisfy business requirements at an acceptable cost and/or within a reasonable timeframe. Following more in depth vendor conversations, STO explored alternative procurement strategies and models and determined the debt management system replace could be better addressed by using the existing debt management system and expert-level technicians rather than STO staff. CalTech agreed with this decision. The STO's funding request of $1.4 million remains unchanged.

Background: The STO received funding for this project in 2013-14 and 2014-15. The new system is necessary for debt administration, including duties associated with trustee, registrar and paying agent responsibilities, payment of debt service, disclosure and analysis of debt issuances. Given the increased legal and financial complexities in the debt markets, the STO indicates a need for a new system to administer outstanding debt, track and pay debt service and fees on outstanding debt, and track and validate the issuance of new debt. The existing system dates to 2004.

Staff Comments: Staff has no concerns with the proposal based on the revised procurement approach, but the STO should be prepared to walk through the proposed revised procurement strategy at hearing.

Staff Recommendation: Approve the may Revision request with the revised procurement approach.

Vote:

0000 Redevelopment Agencies / Local Government

Issue 1: Redevelopment Agencies Dissolution and Local Government Issues Resolution (Trailer Bill Language)

Background: Ongoing workload related to the winding down of redevelopment agencies (RDAs) involves the generation, submittal, and review of Recognized Obligation Payment Schedules (ROPS). Every six months, operating under the supervision of a locally appointed oversight board, successor agencies must submit to the DOF their ROPS, which delineates their proposed payments during the upcoming payment cycle. The DOF reviews each ROPS to determine whether the identified payments are required by enforceable obligations, as defined by law. Once the DOF has completed its review, county auditors-controllers provide successor agencies with property tax allocations to pay the approved enforceable obligations. This process continues into the future until all the approved enforceable obligations have been paid.

Through this biannual process, DOF has reviewed the majority of all enforceable obligations listed for payment by successor agencies for compliance with the law. According to DOF, about 85 percent of all active successor agencies have complied with statutory audit findings and received a finding of completion, indicating compliance progress. As a result, DOF avers that oversight of the dissolution process has progressed to the point where legislative changes can be considered in order to add finality to the entire dissolution process and reduce the burden on all parties involved.

In addition to RDA wind-down issues, there are a number of ongoing situations related to the state/local fiscal relationship that have arisen over the years as unintended consequences of various actions. These situations involve newly incorporated cities, compensating local governments for various revenue losses, and cases of unintended miscalculations of amounts owed to schools.

Governor's Proposal: In what it terms an effort to "…minimize the potential erosion of property tax residuals being returned to the local affected taxing entities…clarify and refine various provisions in statute to eliminate ambiguity…(and) maintain the expeditious wind-down of RDA activities…" the Administration has proposed legislation that would include the following steps:

- Transition all successor agencies from a biannual ROPS process to an annual ROPS process beginning July 1, 2016, when the successor agencies transition to a countywide oversight board.

- Establish a "last and final" ROPS process beginning September 2015. The last and final ROPS will be available only to successor agencies that have a finding of completion, are in agreement with DOF on what items qualify for payment, and meet other specified conditions. If approved by DOF, the last and final ROPS would be binding on all parties and the successor agency will no longer submit a ROPS to DOF or the oversight board. The county auditor-controller would remit the authorized funds to the successor agency in accordance with the approved last and final ROPS until each remaining enforceable obligation has been fully paid.

- Clarify that former tax increment caps and RDA plan expirations do not apply for the purposes of paying approved enforceable obligations. This clarification would confirm that funding will continue to flow until all approved enforceable obligations have been paid.

- Specify that re-entered agreements that are not for the purpose of providing administrative support activities are not authorized or enforceable.

- Stipulate that litigation expenses associated with challenging dissolution determinations are not separate enforceable obligations, but rather are part of the administrative costs of the successor agency.

- Establish that contractual and statutory pass-through payments end upon termination of all of a successor agency's enforceable obligations.

- Indicate that DOF is exempt from the regulatory process and specify that county auditor‑controllers' offices shall serve as staff for countywide oversight boards.

May Revision Proposal: The May Revision includes substantial additional provisions to the proposal, including changes to the provisions listed above. The major new and altered components include:

- **Findings of Completion**. Allows successor agencies that enter into a written payment agreement with Department of Finance to remit their unencumbered RDA cash assets to the county auditor-controller to receive a finding of completion.

- **Stranded 2011 Bond Proceeds**. Provides that successor agencies with a finding of completion may expend a portion of these stranded proceeds—based on a 'tiered' expenditure structure—with the unused portions to be used to defease the outstanding bonds.

- **Property Tax "Override" Revenues**. Clarifies that any pension or State Water Project override revenues pledged to RDA debt service must be used for that purpose, with certain limitations.

- **Highway Infrastructure Improvements**. Allows agreements between the former RDA and its sponsoring entity that relate to state highway infrastructure improvements to be an enforceable obligation.

- **Litigation Expenses**. Clarifies that a sponsoring entity can loan money to a successor agency for litigation expenses associated with challenging dissolution decisions and those loaned amounts may be repaid as an enforceable obligation if the litigation is successful.

- **Reentered Agreements**. Clarifies, as a result of a final court decision, that reentered agreements entered into after the passage of AB 1484 (Committee on Budget), Chapter 26, Statutes of 2012, are unauthorized and unenforceable, unless they were for the purpose of providing administrative support activities.

The May Revision includes several proposals for local governments related primarily to long-running issues involving the state-local fiscal relationship. Specifically, the proposals include:

- **"Negative Bailout" Counties.** Ends negative bailout, which will provide approximately $6.9 million in annual relief to four counties. Negative bailout occurs if the health and welfare costs that the state assumed for a county exceed the additional property tax the county receives from the schools (pursuant to the post Proposition 13 property tax shift), reducing through statute the county's property tax revenue by the difference.

- **Newly Incorporated Cities.** Provides fiscal relief for specified cities in Riverside County incorporated after 2004. The cities—Jurupa Valley, Menife and Wildomar experienced fiscal stress due to lost revenue from the VLF swap, for which they were ineligible, and the loss of the enhanced VLF rate redirected in 2011 to fund public safety realignment.

- **San Benito County.** Allows the County of San Benito to participate in an Educational Revenue Augmentation Fund (ERAF) repayment program, for which they are currently ineligible, in order to pay amounts owed to the ERAF. The proposal results in the state forgiving approximately $3.4 million of the $4 million owed by the county.

- **Tax Equity Allocations (TEA).** Ends, over a five-year period, the requirement of four cities in Santa Clara County to reimburse the county for the loss of ERAF due to the TEA. TEA provide property tax to cities that levied little or no property tax prior to Proposition 13, by shifting property taxes from the county.

Legislative Analyst's Perspective. The Legislative Analyst's Office (LAO) indicates that the revised redevelopment proposal appears to reflect the feedback of local agencies and, therefore, seem to find a reasonable middle ground. Specifically, eliminating retroactive invalidation of certain reentered agreements and creating a mechanism for successor agencies to recover litigation costs from successful challenges to DOF's implementation of the dissolution statutes addresses concerns raised by local agencies throughout the budget process. In addition, the May Revision change related to property tax override revenues addresses an issue that local agencies have raised several times in recent years. DOF's proposed solution to this issue appears consistent with the goals of redevelopment dissolution, namely (1) ensuring former redevelopment obligations are honored and (2) returning property tax revenues to the entities that would have received them in the absence of redevelopment. Several proposed changes to redevelopment dissolution law would have the net effect of increasing General Fund costs by as much as several tens of millions of dollars annually.

With respect to the general local government provisions, the LAO notes that there are many real and perceived inequities in the way property taxes are divided among local governments and the May Revision proposes changes that would address a subset of local concerns with the property tax allocation system. In some cases, very similar issues exist in other counties that would not be addressed by the proposal, and addressing some issues but not others could create additional calls for General Fund spending in future years to fix other perceived inequities in the property tax system. Finally, LAO recommends weighs the newly incorporated cities' need for aid against other competing General Fund spending priorities, but indicates to the extent the Legislature wishes to provide assistance to the new cities, the Governor's approach seems like a reasonable starting point.

Staff Comments: The May Revision includes a number of additional proposals that would benefit cities and successor agencies to the dissolved RDAs. For a few cities, there remain questions, including the interest rate on loans to be repaid to sponsoring cities. The other local government-related issues represent a reasonable approach to long-festering issues. Overall, the proposal is a reasonable proposal and represents an attempt to move beyond the dissolution battles, and contains substantial benefits for local governments and the state.

Staff Recommendation: Approve placeholder trailer bill language.

Vote:

7730 Franchise Tax Board

Issue 1: Earned Income Tax Credit (Trailer Bill Language)

Governor's Proposal: The May Revision proposes the creation of a state Earned Income Tax Credit (EITC). This proposal, which adopts an option developed by the Legislative Analysts' Office (LAO), will provide a refundable tax credit for wage income and would focus on households with incomes less than $6,580 if there are no dependents and up to $13,870 if there are three or more dependents. The proposed state program dovetails with the existing federal EITC and would match 85 percent of the federal credits up to half of the federal phase-in range and then begin to taper off relative to these maximum wage amounts. The credit will be available beginning with tax returns filed for wages earned in 2015 and is expected to reduce revenues by $380 million annually beginning in 2015-16. It will benefit an estimated 825,000 families and 2 million individuals. The estimated average household benefit is $460 per year with a maximum credit for a household with three or more dependents of over $2,600.

Background: The federal EITC is the largest tax benefit for families with children and is the third largest social welfare program in the United Stated behind Medicaid and food stamps. The EITC was first enacted at the federal level in 1975 as a modest refundable credit of up to $400. The credit equals a percentage of earnings for an individual until the earnings reach a maximum amount (phase-in range). The credit then plateaus for additional levels of income (flat range) until reaching a specified income level, at which point the credit is gradually phased out (phase-out range). Because the EITC is targeted at lower-income households, it includes a phase-out as income levels rise. For 2015, the maximum federal credit for a single worker with no children is estimated to be $503 based on a 7.65-percent credit rate on earnings up to $6,580. The maximum credit for a family with three children is estimated to be $6,242 on a 45-percent credit rate on earnings up to $13,870.

Twenty-five states plus the District of Columbia currently have an EITC. The majority (21) provide a refundable credit—meaning that the credit is available as a payment to the taxpayer in the event that the tax liability is less than the credit amount. All states set their EITC as a percentage of the federal credit, and most states conform to the federal program in all other aspects such as eligibility requirements and income levels. California has never offered an EITC. In 2012, approximately 3.2 million Californians filed a federal tax return claiming this credit, for a participation rate of about 75 percent of those eligible.

Proposal Detail: The proposed state EITC is structured to complement the federal EITC and will provide a refundable tax credit for households with incomes less than $6,580 if there are no dependents or $13,870 if there are three or more dependents. The proposed state credit would match 85 percent of the federal credits up to half of the federal phase-in range and then begin to taper off relative to these maximum wage amounts. This targeted approach is designed allow a greater benefit per household, given the amount of available resources. The table below illustrates the interaction between the state and federal EITC and the total benefits estimated until the California EITC maximum is reached for two taxpayer classifications. Individuals earning more than the state credit maximums would continue to receive a federal EITC through the phase out range.

Proposed Earned Income tax Credit
Wage Income and Credit Amounts

	No Dependents				**Three or More Dependents**			
	Wage Income	Federal EITC	State EITC	Total EITC	Wage Income	Federal EITC	State EITC	Total EITC
Phase-In Range	$1,000	$77	$65	$142	$2,000	$900	$765	$1,665
	2,000	153	130	283	4,000	1,800	1,530	3,330
	3,000	230	195	425	6,000	2,700	2,295	4,995
Phase-Out Range	3,290	252	214	466	6,935	3,121	2,653	5,773
	4,500	344	135	480	10,000	4,500	1,480	5,980
	6,580	503	-	503	13,870	6,242	-	6,242

Legislative Analyst's Perspective: In its review, the LAO notes that while Governor's proposed state credit magnifies incentives to move from no work to part-time work; because the state credit has a relatively low earnings ceiling for eligibility, it would not increase incentives to move to full-time work, since a full-time worker in a minimum wage job would earn too much over a full year to qualify. However, the earnings level at which the proposed state credit completely phases out corresponds to the end of the phase-in range for the federal EITC. In this way, eligibility for the proposed state EITC would end at just the income at which the maximum federal EITC benefit is reached. LAO also notes several trade-offs in the Governor's approach including: targeting the benefit to very low income as opposed to a broader number of potential beneficiaries; reducing the potential for improper payments versus excluding earnings from self-employment; and, ensuring state fiscal flexibility (by yearly recalibration of the 85 percent) as opposed to more certainty for recipients.

Staff Comments: The federal EITC has long been regarded as an effective and efficient program to direct resources to low-income households while theoretically providing work incentives. State EITCs, including the one proposed by the Governor, may channel additional resources towards low-income families, but are likely to have only a marginal work incentive effect, due to the credit amount available. While the maximum credit under the Governor's proposal is around $2,600, DOF indicates that the mean credit is about $460. In discussions with staff, DOF indicated that the median—arguably a more suitable measure of central tendency of the credit—is "probably between $150 and $200." (The median is the midpoint at which 50 percent of households would receive more and 50 percent less than that amount.) The design of the state EITC dovetails with the design of the federal EITC, and should be measured against other alternative programs in terms of its impact on low–income households.

Questions:

Department of Finance / Franchise Tax Board

1. The EITC proposal is scored as a reduction in revenues, whereas most refundable credits require an appropriation. Can you reconcile these two aspects for purposes of the proposal?

2. How will the adjustment factor be determined? If the adjustment factor is reduced from the previous year in the annual budget act, would this constitute a tax increase?

3. Recognizing that the Administration indicates that there is no effect on the Proposition 98 guarantee in the budget year—since the implementation of the proposal would move the state from Test 2 to Test 3 (plus the supplemental payment)—are there circumstance win which Proposition 98 would be affected?

4. The mean amount of the credit is stated to be $460, but there has been an indication that the median credit—a more robust measure in a dispersed credit 'population'—is likely between $150 and $200. What impact is a credit of this magnitude likely to have as a work incentive?

Staff Recommendation: Hold open.

Vote:

Issue 2: Earned Income Tax Credit Implementation (May Revision)

May Revision Proposal: The Franchise Tax Board (FTB) would be responsible for administering the proposed EITC program. It requests $22.0 million (General Fund) and 98 position equivalents in 2015-16, and General Fund of $11.6 million and $10.1 million in 2016-17 and 2017-18 to implement the credit. This includes one-time contract funds ($12.9 million) to support system changes required to implement a refundable tax credit and a six-month delay associated with the Enterprise Data to Revenue project that is necessary to implement the EITC for the 2015 filing season. A total of 98 positions, including temporary help, and $22 million is needed in 2015-16, specifically: return processing (33 positions), tax payer advocacy/call center support (30 positions), fraud prevention (26 positions), and information technology/tax forms (9 positions) In addition, the budget proposes provisional language to specify the annual adjustment factor applied to the credit rate (85 percent for 2015) to allow the rate to be adjusted annually as part of the budget development process.

Background: General background regarding the EITC is provided in the Issue 1. Given the high levels of improper refund payments that have been experience by both the federal EITC and in other states, various options were considered to limit potential overpayments. First, the state EITC will generally follow the income levels and eligibility requirements of the federal EITC, but will be limited to wage income, excluding self-employment income. In addition, additional staff is proposed for the FTB to educate taxpayers and tax professionals, accelerate review of refund claims before issuance of payments, and modify the Enterprise Data to Revenue system to provide automated checks. These safeguards will prevent limited funds available for this program from being improperly paid to individuals.

Staff Recommendation: Hold open.

Vote: