Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair

Senator Janet Nguyen
Senator Richard Pan

Thursday, April 9, 2015
9:30 a.m. or Upon Adjournment of Session
Rose Ann Vuich Hearing Room 2040

Consultant: Mark Ibele

Agenda

Local Government and Economic Development

Discussion / Vote Calendar

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Discussion / Vote Calendar

0000 Redevelopment Agencies

Issue 1: Redevelopment Agencies Dissolution Status (Informational Item)

Presentation: **Department of Finance**

Comments: **Legislative Analyst's Office**

Background: AB 26 X1 (Blumenfield), Chapter 5, Statutes of 2011, First Extraordinary Session, eliminated the state's approximately 400 redevelopment agencies (RDAs), replacing them with locally-organized successor agencies assigned with the task of retiring the outstanding debts and other legal obligations of the RDAs. The process of winding down redevelopment agencies was not expected to be a straightforward process without uncertainty and controversy. Yet, the extreme complexity of dissolving the program has befuddled many, delaying the receipt of property taxes by school districts and resulting in a lack of clarity for local governments.

In particular, allowing for the continuation of certain projects that meet pre-established criteria has proven to be more complex than most observers initially anticipated. As we noted last year, projects which are partially complete or require changes to existing agreements posed particular problems, and these problems have persisted, although at a reduced level in the last year. Local governments with various projects have raised questions regarding the application of the criteria, the consistency with which the criteria are applied, and what constitutes a reasonable level of state involvement with respect to local projects. Some local governments have expressed the view that the Administration has attempted to curtail projects in too aggressive a manner, given the intent of the enabling statutes, and has sought to establish on-going state review of activities that was not contemplated. Most, but not all, of these issues have been resolved over the last year.

The Administration is continuing the ongoing workload involved with winding down the state's former RDAs. From 2011-12 to 2013-14, approximately $990 million in property tax revenue has been returned to cities, $1.3 billion to counties, and $430 million to special districts. The budget anticipates that in 2014-15 and 2015-16 combined, cities will receive an additional $580 million, counties $660 million, and special districts $200 million. The budget anticipates ongoing property tax revenues of more than $900 million annually will be distributed to cities, counties, and special districts.

From 2011-12 through 2013-14, approximately $3.5 billion was returned to K-14 schools. The budget anticipates Proposition 98 General Fund savings resulting from the dissolution of RDAs will be $875 million in 2014-15. For 2015-16, Proposition 98 General Fund savings are expected to be $1 billion. On an ongoing basis, Proposition 98 General Fund savings are estimated to be over $1 billion annually. When Test 1 of the Proposition 98 calculation is operative, funds above the estimated $1 billion will increase available resources for K-14 schools.

Staff Comments: The Department of Finance (DOF) should provide detail regarding the wind-down of the RDAs and how they have dealt with some of the major issues. DOF staff should also provide information regarding when the process can be removed from state oversight and an indication of the future trajectory of property tax revenue flowing to local governments (cities, counties, special districts and school districts).The Legislative Analyst's Office (LAO) should comment on the process as well.

Staff Recommendation: Informational issue.

Issue for Discussion / Vote:

Issue 2: Redevelopment Agencies Dissolution Proposal (Trailer Bill Language)

Panel 1: **Department of Finance**
League of Cities

Panel 2: **City of Riverside**
City of Watsonville
City of Glendale

Panel 3 **California Special Districts Association**
County of Santa Clara

Background: General information regarding the dissolution of RDAs is presented in Issue 1, above. The DOF notes that ongoing workload related to the winding down of redevelopment agencies 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.

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.

Staff Comments: DOF considers the proposed language as constituting simplifications and clarifications. However, other parties that would be affected by the legislation raised concerns about the proposed language. The League of California Cities (LCC) has indicated that the proposed statute contains provisions that it believes have retroactive impacts on calculated interest rates, repayment of loans from cities to successor agencies, DOF's exemption from the administrative procedures act, and certain activities of successor agencies. In addition, the LCC indicates that the proposal undercuts local agencies' abilities to recoup legal expenses and overturns previous court decisions regarding various re-entered agreements. Representatives of other taxing entities have indicated qualified support for certain aspects of the proposal as a means to clarify the existing process and assure the steady increase in the direction of property taxes revenues to core governmental services. In meetings with legislative staff, DOF has indicated some flexibility on certain aspects of the proposal, suggesting that it would continue to work with local government stakeholders. DOF also indicates that a revised proposal will be issued in conjunction with the May Revision.

Staff Recommendation: Hold open.

Vote:

0509 Governor's Office of Business and Economic Development

Department Overview: The Governor's Office of Business and Economic Development (GO-Biz) was created to serve as a single point of contact for economic development and job creation efforts. The department offers a range of services to businesses, including: business attraction, retention and expansion services; site location selection; permit assistance; regulatory filing and approval assistance; small business assistance; international trade development; and, assistance with state government. Under the reorganization plan from a few years ago, the Infrastructure Development Bank, the California Film Commission, the Office of Tourism, and the Small Business Loan Guarantee Program were relocated from the Business, Transportation and Housing Agency to GO-Biz.

Budget Overview: In the current year, the department is budgeted for $25.4 million and 89 positions. Most of the funding (46 percent) is derived from General Fund, with an additional 38 percent of the budget coming from the California Infrastructure and Economic Development Bank Fund. For 2015-16, GO-Biz is proposed to be funded at $23.5 million, and 97.3 positions.

<u>Issue for Vote-Only:</u>

Issue 1: Small Business Expansion Fund (Budget Bill Language)

Governor's Proposal: Current provisional language in the budget for GO-Biz contains obsolete language and refers to no-longer applicable code sections. The proposal would rectify existing language, as shown below:

> 0509-011-0001—For transfer, upon order of the Director of Finance, to the Small Business Expansion Fund.... 861,000
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> Provisions: If the ~~trust fund described in Section 14030 of the Corporations Code~~ *Small Business Expansion Fund described in Section 63089.5 of the Government Code* incurs losses due to loan defaults and this results in outstanding guarantee liability exceeding five times the portion of funds on deposit in the *Small Business Expansion Fund*, ~~trust fund as specified in that section,~~ the Director of Finance may transfer an amount necessary from the General Fund to the *Small Business Expansion Fund* ~~trust fund~~ to maintain the minimum reserves required ~~by that section~~ *for the Small Business Expansion Fund.* The Director of Finance shall notify the Joint Legislative Budget Committee within 30 days of making such a transfer. In no case shall a transfer or transfers made pursuant to this provision exceed the total amount of $20,000,000. Any amount transferred pursuant to this provision, shall be repaid to the General Fund, upon the order of the Director of Finance, when no longer needed to maintain a minimum required reserve.

Staff Comments: Staff has no concerns with the proposal.

Staff Recommendation: Approve technical changes to existing budget bill language.

Vote:

Issue for Discussion:

Issue 2: California Competes Tax Credit Program (Informational Issue)

Program Outline: AB 93 (Committee on Budget), Chapter 69, Statutes of 2013 and SB 90 (Galgiani), Chapter 70, Statutes of 2013, together formed the basis of the revisions to local economic development programs. This legislative package included the elimination of enterprise zone programs, and enactment of: a sales tax exemption for certain capital purchases, a geographic specific hiring credit, and a targeted tax credit for specific businesses. The sales tax exemption is administered by the Board of Equalization and the hiring credit by the Franchise Tax Board. The targeted tax credit—termed the California Competes Tax Credit (CCTC)—is administered by GO-Biz and the Franchise Tax Board (FTB).

Program Details: In its administration of the CCTC, GO-Biz is responsible for a relatively new program that involves a sizeable commitment of state funds, in the form of revenues foregone, over several years. The funds ‘flow’ based on negotiated contracts with private companies. The purpose of the CCTC is to attract, expand, and retain businesses in California. The businesses that apply for the credit are evaluated on the basis of number of employees; jobs created or retained; location of the company in the state; and magnitude of investment by the business. The tax credit packages are negotiated between the business and the Administration (GO-Biz) and then voted on by the GO-Biz committee, consisting of the director of GO-Biz, the director of the Department of Finance, the State Treasurer, and one appointee each from the Senate and the Assembly.

Taxpayers may receive a maximum of 20 percent of the total amount of credits available for a particular year. In addition, 25 percent of the available credits must be provided to small businesses (companies with gross receipts of $2 million or less). The amount of credits that are allocated is up to $30 million in 2013-14, $150 million in 2014-15 and $200 million for years 2015-16 through 2017-18. These amounts may be reduced in order to ensure the total amount of tax reductions resulting from the three tax preference programs described above is no greater than $750 million in a fiscal year.

Program Administration and Status: In its December 2014 report to the Legislature, GO-Biz provided an outline of the evaluation process together with results to date. The implementation of the program is defined based on the application process, evaluation process, negotiation process and committee process, as described below:

- **Application Process.** During this stage of the program, CCTC staff engages in in one-on-one contact with applicants and their designated representatives by providing assistance with computing and entering the required information. CCTC staff also confirms eligibility, explains regulations, recommends other resources and provides information about deadlines.

- **Evaluation Process.** The evaluation process is two-phased. The initial phase determines the cost-benefit ration from the state's perspective, based on the credit request, aggregate employee compensation, and aggregate investment. The most completive proposals move to the second evaluative phase. The second phase involves looking at specific selection criteria, including number of jobs, amount of investment, extent of unemployment and poverty in the project are, and opportunity for additional growth.[1]

- **Negotiation Process.** Contract negotiations require a significant amount of analysis and discussion between CCTC staff and the applicant. The intent is to reach specific agreements that create definitive milestones, explain agreement provisions, and tailor language specific to the project.

- **Committee Process.** At this stage, CCTC staff briefs committee members and presents the negotiated agreements for approval at a public hearing. It also informs the Franchise Tax Board (FTB) of the approved items and conditions of the agreements and posts information on the awards to the website.

In its December 2014 report, GO-Biz indicates that for fiscal year 2013-14, during the initial round of funding, 396 applicants requested over $500 million in credits. Of those applications, 149 progressed to the second phase of the evaluation, and 29 were awarded $28.9 million in credits of the $30 million available. For the initial application period for 2014-15, 286 applications have been received requesting $330 million in credits of the $45 million available. There will be two additional application periods this fiscal year for an additional $10.1 million. GO-Biz should be prepared present updated figures at the hearing.

Other GO-Biz Initiatives: Go-Biz has also pursued significant economic development proposals outside of the AB 93 framework, specifically: Lockheed Martin tax credit ($420 million over 15 years); Northrup Grumman tax credit (accompanying measure); film tax credit extension/expansion (more than $1.5 billion over five years); Tesla 'gigafactory' (unsuccessful). The Administration deemed these agreements as too substantial to occur within the AB 93 parameters and pursued them as independent pieces of legislation. Nevertheless, the sizeable commitment of additional foregone General Fund resources was not contemplated as part of the AB 93 conversation.

Staff Comments: While programs similar to the CCTC are used in other states with varying degrees of success, this approach to business development and assistance is not one that California has used in the past. Given this new approach to awarding tax

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[1] The specific criteria are: a) the number of jobs created or retained in the state; b) the compensation paid to employees, including wages and fringe benefits; c) the amount of investment in the state; d) the extent of employment or poverty where the business is located; e) the incentives available to the business in the state; f) the incentives available to the business in other states; g) the duration of the business's proposed project and the duration the business commits to remain in this state; h) the overall economic impact; i) the strategic importance to the state, region or locality; the opportunity for growth and expansion; the extent to which the anticipated benefit to the state exceeds the projected benefit to the business from the tax credit.

credits, it is important that the Legislature be vigilant in its oversight of the program, to ensure that it is implemented in as effective a manner possible. The committee may wish to have the GO-Biz provide an update on the development and implementation of the program.

One of the underlying problems associated with traditional open-ended tax incentives is that the majority of the tax benefit goes to businesses that would have engaged in the desired behavior irrespective of the incentive program. Put another way, only businesses operating 'on the margin' would engage in the desired behavior ***because*** of the incentive. The result is a significant loss in revenue with no associated impact on economic activity. The GO-Biz CCTC program attempts to eliminate or minimize this loss by targeting its incentives at companies on the margin; its ability to do this, however, is open to question (as it would be for any outside entity attempting to measure internal business investment decisions). One way to measure success in this regard would be to conduct a study of companies that met the cost-benefit threshold (initial evaluation phase) and were among the finalists in selected criteria (second evaluation phase), but for one reason or another, were not selected as credit recipient. GO-Biz could use the results of this to improve their filtering and selection methods and measure the effectiveness of their analyses.

As noted above, some of the sizeable initiatives undertaken by GO-Biz have been outside of the parameters established in the legislation establishing the California Competes Tax Credit. Notably, these efforts involved the Lockheed Martin tax credit, Northrup Grumman tax credit, the film tax credit extension/expansion and the unsuccessful efforts directed towards the Tesla 'gigafactory.' In large part, the details surrounding these incentive efforts were provided to the Legislature deep into the legislative session under a compressed schedule, making thorough independent analysis and review very challenging. The subcommittee may consider the value of regular quarterly or biannual meetings with GO-Biz staff, such that leadership is kept current on potential agreements. This could be of particular value for agreements with a significant budgetary impact that could affect the funding of the Legislature's own priorities.

Questions:

Governor's Office of Business and Economic Development

1. The effectiveness of the CCTC program is predicated on the ability to reasonably determine whether the jobs and investment would either not be retained or not created absent the existence of the credit. Based on self-assessment, what is your confidence on GO-Biz's ability to do this? What evidence do you weigh in this determination?

2. Could you discuss the possibility of conducting an after-the-fact assessment of companies that would otherwise have qualified for the credit, but because of the competition, were not selected? Such an assessment could be used to determine

whether—in fact—the jobs were not created or retained due to the lack of incentives. This could lead to improvements in CCTC assessment methods.

3. There may be a perception by some businesses located in the state that while they are paying their fair-share in taxes, other businesses that succeed in making a case to GO-Biz, essentially get ‘paid’ to locate or keep their businesses in California. How do you respond to such criticism that credits awarded to particular companies essentially “un-level the playing field,” at a time when all the focus seems to be on leveling it?

4. While the Legislature enacted a process for the CCTC, much of the biggest commitment by the state has been through isolated proposals initiated late in the legislative session. How does the Administration see proceeding on these initiatives in the future in a manner that allows for adequate oversight and analysis by the Legislature?

Legislative Analyst’s Office

1. Could you comment on the potential feasibility and possible design of study to examine the effectiveness and efficiency of the CCTC program, particularly its ability to isolate companies where the award of the incentive is crucial to the creation or retention of jobs and investment?

Staff Recommendation: Informational issue.

Issue for Discussion / Vote:

Issue 3: California Film Commission Film Tax Credit Program (Governor's Budget BCP 1)

Background: The California Film Commission (CFC) is a program that exists within GO-Biz and serves as the state's primary liaison between the film production community and various state and local governments. The stated goal of CFC is to support California's film industry by offering a variety of support services and incentives. Among its other programs, the CFC administers the current film tax credit, established pursuant to AB 2026 (Fuentes), Chapter 842, Statutes of 2012, which sunsets in 2016-17 and phases out in 2017-18. In addition, CFC will administer the new film tax credit, established in AB 1839 (Gatto), Chapter 413, Statutes of 2014. The new program will begin in the budget year (2015-16), resulting in some overlap in the two programs. The new program significantly expands the size and scope of the incentive program. Annual credits will increase from $100 million to $330 million ($230 million in the initial year), with more than $1.5 billion to be awarded over a five-year period. AB 1839 allows a tax credit to a qualified taxpayer for certain costs incurred in the production of a qualified motion picture. Taxpayers can receive a 20 percent tax credit (in some cases 25 percent) on specified qualified expenditures and wages.

Governor's Proposal: The Governor's budget includes a request for $1.1 million in the budget year and $802,000 annually thereafter, and nine positions for the CFC to implement AB 1839 (current staff for the existing program is two positions). AB 1839 created a new film tax credit which expanded eligibility and tripled funding from the current film tax credit. The CFC is directed to administer the new program which will require the implementation of two or more application periods per fiscal year for specific types of productions, utilizing a new ranking system to determine which projects will receive a credit based on job creation and economic impact. The request would allow for the funding of a tax credit program director, program administrator, three tax credit program associates, program coordinator, and three program assistants. The request is inclusive of two positions already administering the existing program. The CFC request is based on the increased size and complexity of the new film tax credit program. For example, in contrast to the current first come-first served lottery approach of the current program, the new program involves a relatively sophisticated ranking system for projects.

Staff Comments: Given the adoption of the film tax credit legislation, staff does not have any fundamental concerns with the narrow budget request proposal, but notes significant issues related to programs of this type, as discussed briefly below.

The credit created by AB 1839 represents a significant commitment of state resources—some $1.5 billion in incentives granted over a period of five years. Programs of this sort, which essentially shift the state's tax burden away from a specific industry and onto taxpayers at large, are not without controversy and it would behoove the commission to institute careful internal studies of the effectiveness of this program, rather than relying on selected statistics that lend support to program. Programs that select individual industries or businesses for favored treatment are fraught with potential pitfalls, including the most common one of equating program over-subscription with success.

In fact, most economic analyses of incentives of this type find significant variation in ability of program administrators to select activities that are actually on the margin between locating in California and elsewhere. As noted in the issue discussed above, without such a determination, the overall efficiency of the program is in question. A well-designed program would result in incentives that are just sufficient (and no greater than sufficient) to cause a project to locate in California—and then only projects where a threshold net benefit-cost ratio for the state is exceeded. The commission cites a figure of 84 percent of projects that were denied the credit being produced elsewhere. While this snapshot may or may not be indicative of the program's overall effectiveness, it falls well short of a comprehensive analysis.

In its report in April 2014 on the state's existing film incentive, the Legislative Analyst's Office (LAO) concluded that the film tax credit does not pay for itself and its economic benefits are overstated. As part of earlier legislation creating the film credit—AB 2026 (Fuentes), Chapter 842, Statutes of 2012, and the most recent legislative in AB 1839—the LAO is directed to provide reports on the effectiveness of the program by January 2016 and July 2019. The LAO notes that it expects the required reports to "…lack…conclusive evidence…" of the program's effectiveness. Nevertheless, given the level of resource commitment, it would be appropriate to assess whether the CFC is in the process of collecting and compiling data and information that can make the report as helpful and conclusive as possible regarding the effectiveness of the program. With the decision to grant significant resources to a specific industry, any long-term commitment should informed by as comprehensive an approach and conclusive findings as possible.

Questions:

Legislative Analyst's Office

1. Acknowledging that your reports are not due this year and are still in the conceptual stage, could you comment on what your preliminary approach of investigation might be, such that the Legislature can gain access to the information it needs to improve the performance of program like these?

Staff Recommendation: Approve as budgeted.

Vote:

8885 Commission on State Mandates

Department Overview: The Commission on State Mandates (commission) is a quasi-judicial body created for the purpose of determining state-mandated costs. The objective of the commission is to impartially hear and determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state, consistent with Article XIII B, Section 6 of the California Constitution. The commission consists of the director of Finance, the State Controller, the State Treasurer, the director of the Office of Planning and Research, and a public member and two local government representatives appointed by the Governor and approved by the Senate.

Background: The commission is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments, and for establishing the appropriate reimbursement to local governments from a mandate claim. The Constitution generally requires the state to reimburse local governments when it mandates that they provide a new program or higher level of service. Activities or services required by the Constitution are not considered reimbursable mandates. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. Payments for mandate costs incurred prior to 2004 are one exception noted in the Constitution—such pre-2004 mandate costs can be repaid over time. Another exception in the Constitution is for mandates related to labor relations. In these cases, the state can defer payment of the mandates and still retain the mandates' requirements. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution.

Mandate reimbursement claims are filed with the commission for the prior fiscal year—after that fiscal year is completed and actual costs are known. The state pays the mandate claims in the following fiscal year. For example, local costs incurred in 2013-14 are reported and claimed in 2014-15, and the state will reimburse locals for these costs as part of the 2015-16 budget. Suspending a mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment. For example, several elections-related mandates were suspended for the first time in the 2011-12 budget. This means the activities for locals were optional in 2011-12 and locals cannot claim reimbursement for any new costs incurred in 2011-12. However, the mandate claims for these costs in 2009-10 and 2010-11 are still due—either over time or all at once in the year when the mandate suspension is lifted.

The state owes local governments approximately $1.8 billion in non-education mandate payments. Of this, about $790 million (which includes interest of $170 million) is associated with pre-2004 mandate claims. Pursuant to the constitutionally-required reimbursement, the 2014-15 budget included $100 million to reduce the outstanding balance for pre-2004 local government mandate claims. In addition, the current year budget incorporated a trigger mechanism that could result in an additional payment under specified conditions. This trigger will be activated if May Revision estimated revenues for the two years exceed the prior year's May Revision estimated revenues.

The Department of Finance currently estimates that the trigger amount that will be paid is $533 million, leaving $257 million remaining to be paid by 2020-21, as required by the passage of Proposition 1A.

Budget Overview: For 2014-15, the commission was budgeted at $1.9 million and 13 positions for state operations. This administrative support level was increased slightly from the prior year's funding of $1.8 million. For 2015-16, the administrative support resources will remain flat. Costs associated with funding mandates proposed in the Governor's budget for 2015-16 are approximately $46.8 million (all funds) and $44.2 (General Fund). Estimated mandate payments in the current year are much greater at $669.5 million, due largely to a trigger for the payment of mandate costs owed on pre-2004 claims, as described further below.

Issue for Discussion:

Issue 1: Mandate Process and Timing (Informational)

Background: Determining whether a particular requirement is a state-mandated local program, and the process by which the reimbursable cost is determined, is an extensive, time-consuming, and multi-stage undertaking. State and local officials have expressed significant concerns about the mandate determination process, especially its length and the complexity of reimbursement claiming methodologies.

In the past it took the commission several years to complete the mandate determination process for a successful local government test claimant. A past review of new mandates claims found that the commission took almost three years, from the date a test claim was filed, to render a decision as to the existence of a state-reimbursable mandate. The commission took about another year to adopt the mandate's claiming methodology, and almost another year to estimate the costs and report the mandate to the Legislature.

With the receipt of additional resources in prior years, the commission has attempted address the backlog and timing issues that are within its purview. The result has been a significant reduction in the elapsed time between when the test claim was submitted and the statewide cost estimate was issued. Based on data provided by the commission, for recent mandates the duration of this process has been reduced to a range of two to three years.

Staff Comments: Commission staff indicates that progress has been made regarding reducing the administrative backlog associated with the mandate process and the time involved in the process. That is, the additional resources budgeted for the commission have had a beneficial impact. Clearly, this is only the administrative component of a larger local mandate issue, but it nevertheless is a positive sign. The resources appear to have resulted in reducing the delays that have been endemic to the current system. It is important to note that delays are not necessarily within the commission's control. In particular, there can be great variation—sometimes years—as to when local agencies file a test claim. The result is that a significant period of time can elapse between the enactment of the statute triggering the reimbursable mandate, and the statewide cost estimate (and determination of reimbursement amounts).

Questions:

Commission on State Mandates

1. Can you describe the experience of the commission in shortening the time frame for the mandate process based on the additional resources received? Are there opportunities—given adequate resources—to further tighten-up the time-frame, or would statutory—or potentially constitutional changes—be required?

Department of Finance

1. In the past the Administration indicated that it would pursue policies to improve the mandate process, including deferring decisions to local government decision-makers and allowing for maximum flexibility. Please discuss the direction that it has taken (or will be taking) with respect to these reforms.

Staff Recommendation: Informational issue.

Issues for Discussion / Vote

Issue 2: Local Government Funded Mandates (Governor's Budget Proposal)

Background: Most local mandates must be funded through a commitment of General Fund resources. In the recent past, funded mandates have traditionally included those related to public safety and property tax collection.

Governor's Proposal: The Governor's mandate proposal is largely a continuation of the status quo. The budget proposes expenditures of $44.2 million related to non-education mandates. The budget would continue to fund the 13 mandates that were kept in force for 2014-15, the payments on which constitute the bulk of the General Fund cost. In addition, the budget proposes funding a one-time payment of $9.6 million to address the back costs local agencies accrued from 2001 to 2013 in performing activities related to the Public Records Act mandate. (In 2014, California voters approved Proposition 42, which placed the Public Records Act in the Constitution and removed the state's ongoing responsibility to fund the Public Records Act mandate). The budget also provides $218,000 to fund the Accounting for Local Revenue Realignments mandate which involves county administrative costs associated with funding changes in 2003-2004 that addressed budget shortfalls at that time. Two additional funded mandates relate to local agency ethics and tuberculosis control. Funded mandates are listed in the following table:

Mandates Funded in Governor's Budget
General Fund
(Dollars in Thousands)

Mandate Title	Amount
Accounting for Local Revenue Realignments	$218
Allocation of Property Tax Revenue	530
California Public Records Act	9,674
Crime Victim's Domestic Violence Incident Reports	178
Custody of Minors-Child Abduction and Recovery	12,216
Domestic Violence Arrests and Victim's Assistance	1,467
Domestic Violence Arrest Policies	7,481
Domestic Violence Treatment Services	2,082
Health Benefits for Survivors of Public Safety Officers	1,816
Medical Beneficiary Death Notices	10
Peace Officer Personnel Records	704
Rape Victim Counseling	351
Sexually Violent Predators	7,140
Threats Against Police Officers	3
Tuberculosis Control	8
Local Agency Ethics	36
Unitary Countywide Tax Rates	260
Total	**$44,174**

Note: *Italics* indicates that mandate is newly funded in the proposed budget.

Staff Comment: At the time the agenda was finalized, no concerns had been raised with this budget request. The mandates selected for funding generally continue the policy adopted in previous years by the Legislature, with selected additions, as noted. The budget also addresses funding one existing mandate in a new way, in an attempt to deal with its significant costs. The Interagency Child Abuse and Neglect Investigation (ICAN) Reports mandate requires certain local agencies to conduct various activities related to child abuse investigations and to provide reported child abusers due process protections. Instead of a mandate, the budget proposes a $4 million optional grant program, administered by the Department of Social Services, as a substitute funding mechanism for these activities. This will be considered by the Senate Budget Subcommittee No. 3 on Health and Human Services. As presented in the next issue, the budget suspends this mandate on the basis that these activities are long-established and involve the agencies' core missions. The commission adopted a $90.3 million statewide cost estimate which reflects the affected agencies' costs to comply with this mandate from 1999 to 2011.

Staff Recommendation: Approve the budget request for funding of selected local government mandates.

Vote:

Issue 3: Local Government Suspended Mandates (Governor's Budget Proposal)

Background: The budget incorporates a total of $984.5 million in savings from maintaining mandate suspensions or deferring payment of claims. Some 56 mandates are suspended under the budget proposal. In addition, payments on another 15 mandates that have been deferred or have expired have been delayed. The savings breakdown is as follows: (1) $276.4 million savings from deferring payment of post-2004 mandate claims for mandates that have since expired or are otherwise not in effect; (2) $620.3 million savings by continuing the suspension of certain local mandates; and, (3) $87.8 million savings from deferring payment on employee-rights mandates in effect. In prior years, there have been proposals to repeal certain mandates, but no such repeal is proposed in the budget. Repealing mandates does not offer any additional budget savings relative to suspension; however, if the mandate will otherwise be suspended indefinitely, the repeal of statutory provisions cleans up the code, improves statutory transparency, and provides more certainty to local governments.

Governor's Proposal: As part of the 2015-16 budget, the Governor proposes suspending the following local government mandates, generating $620.3 million in savings:

Mandates Suspended in Governor's Budget
General Fund
(Dollars in Thousands)

Mandate Title	Amount
Absentee Ballots	$49,589
Absentee Ballots-Tabulation by Precinct	68
AIDS/Search Warrant	1,582
Airport Land Use Commission/Plans	1,264
Animal Adoption	37,188
Brendon Maguire Act	0
Conservatorship: Developmentally Disabled Adults	349
Coroners Costs	222
Crime Statistics Reports for the Department of Justice & CSRDOJ Amended	154,937
Crime Victims' Domestic Violence Incident Reports II	2,010
Developmentally Disabled Attorneys' Services	1,201
DNA Database & Amendments to Postmortem Examinations: Unidentified Bodies	310
Domestic Violence Background Checks	20,627
Domestic Violence Information	0
Elder Abuse, Law Enforcement Training	0
Extended Commitment, Youth Authority	0
False Reports of Police Misconduct	10
Firearm Hearings for Discharged Inpatients	157
Grand Jury Proceedings	0
ICAN Interagency Child Abuse and Neglect Investigation	90,342
Identity Theft	93,918
In-Home Supportive Services II	443
Inmate AIDS Testing	0

Judiciary Proceedings (for Mentally Retarded Persons)	274
Law Enforcement Sexual Harassment Training	0
Local Coastal Plans	0
Mandate Reimbursement Process I	6,910
Mandate Reimbursement Process II (includes consolidation of MRPI and MRPII)	0
Mentally Disordered Offenders': Treatment as a Condition of Parole	4,910
Mentally Disordered Offenders' Extended Commitments Proceedings	7,222
Mentally Disordered Sex Offenders' Recommitments - Verify Name	340
Mentally Retarded Defendants Representation	36
Missing Person Report III	0
Modified Primary Election	1,817
Not Guilty by Reason of Insanity	5,214
Open Meetings Act/Brown Act Reform	110,593
Pacific Beach Safety:Water Quality and Closures	344
Perinatal Services	2,338
Permanent Absentee Voter II	12,098
Personal Safety Alarm Devices	0
Photographic Record of Evidence	-62
Pocket Masks (CPR)	0
Post Conviction: DNA Court Proceedings	410
Postmortem Examinations:Unidentified Bodies, Human Remains	-466
Prisoner Parental Rights	0
Senior Citizens Property Tax Postponement	481
Sex Crime Confidentiality	0
Sex Offenders: Disclosure by Law Enforcement Officers	0
SIDS Autopsies	0
SIDS Contacts by Local Health Officers	0
SIDS Training for Firefighters	0
Stolen Vehicle Notification	1,117
Structural and Wildland Firefighter Safety Clothing and Equipment	0
Very High Fire Hazard Severity Zones	0
Voter Identification Procedures	10,075
Voter Registration Procedures	2,481
Total	**$620,349**

Staff Comments: In prior years, the Legislative Analyst's Office (LAO) has raised questions regarding a number of the mandates proposed for suspension. Depending on the particular mandate, the recommendations have included funding, repealing, or changing the underlying statute to reflect a best practices approach. The LAO has in the past recommended that the mandates relating to elections in the table above not be suspended but rather funded in the budget, along with the direction that the Administration work with counties to explore alternative funding mechanisms. If these mandates were not suspended, the budgetary impact of funding these mandates would be about $100.0 million on a one-time basis, and a substantially lesser amount of $30.5 million annually thereafter.

Despite the suspension, to date, it appears that no counties have deviated from providing services required pursuant to the previously mandated activities. Given that counties are not required to comply with suspended statutes, there may be a moderate risk that one or more counties may opt not to comply during future elections. According to the LAO, "The longer the state suspends these mandates and the more elections mandates the state chooses to suspend, the greater the risk that at least one county will decide not to perform the previously mandated activities."

As part of the 2014-15 budget, the Legislature approved budget bill language that requires the DOF to provide a report on local election mandates that evaluates simpler mechanisms and alternative funding, assesses as to whether modifications can be made to achieve lower costs, and estimates statewide costs associated with the goals of the mandates. This report, which was recently provided to the Legislature, could provide a prototype for alternative means of mandate implementation and reimbursement of local government activities. Suspending the election mandates would not preclude the Administration from working with counties to adopt one or more of the alternative funding mechanisms, as suggested in the recent report. The subcommittee may request that DOF outline the findings of the report, and LAO should comment.

Other than the issues discussed above, staff is not aware of major concerns being raised regarding the continued suspension of these mandates.

Staff Recommendation: Approve the suspension of the mandates proposed in the Governor's budget.

Vote:

9210 Local Government Financing

Item Overview: The 9210 budget item includes several programs that make state subventions to local governments. In past years, the payments have included General Fund appropriations for constitutionally-required repayment of 2009-10 Proposition 1A borrowing from local governments; a small subvention related to former redevelopment agencies (RDAs) to help retire a portion of outstanding debt that was backed by the personal property tax; and a subvention for counties and cities within those counties for insufficient Educational Revenue Augmentation Fund (ERAF) resources.

Budget Overview: The proposed budget for the 9210 item is $9.9 million General Fund. Of this, $5.1 million is slated for subventions to the counties of Alpine, Amador, and San Mateo (and cities within those counties), $393,000 in trial cost assistance and $4.3 million for the Property Tax Assessors' Partnership Agreement Program. The subventions are related to the so-called 'Triple Flip' and 'Vehicle License Fee (VLF) Swap,' both of which are described below. The Department of Finance (DOF) indicates it will not know the final subvention amounts for each of these counties until the May Revision.

<u>Issues for Discussion / Vote:</u>

Issue 1: Nevada County Trial Costs (Governor's Budget Proposal)

Governor's Proposal: 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.

Background: 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: Staff has no concerns with this proposal.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2: Subventions to Amador, San Mateo and Alpine Counties (Governor's Budget Proposal)

Governor's Proposal: The Governor's budget proposes a General Fund subvention of $5.1 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: $1.5 million to Amador, $3.4 million to San Mateo and $198,000 to Alpine.

Background: Legislation enacted early in the Schwarzenegger Administration shifted local property tax from schools to cities and counties to accommodate two state fiscal initiatives. 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, and it is possible this outcome could occur for a few additional counties in the future.

In the 2004 primary election, voters approved Proposition 58, which allowed the state to sell Economic Recovery Bonds (ERBs) to pay its accumulated budget deficit. The local sales tax for cities and counties was reduced by one-quarter cent and the state sales tax was increased by one-quarter cent to create a dedicated funding source to repay the ERBs. Property tax was redirected from schools to cities and counties, and the state backfilled schools via the Proposition 98 funding guarantee. This financing mechanism is sometimes called the Triple Flip, and the process was intended to hold local governments harmless. At the time the ERBs are repaid (in 2016-17, or earlier under the Governor's budget proposal), the local sales tax rate will be restored, and no flip—triple or otherwise—will be necessary.

Also in 2004, the Legislature enacted the VLF Swap. The measure was designed to provide a more reliable funding mechanism to backfill cities and counties for the local revenue decrease resulting from the action that the reduced the VLF tax on motor vehicle from 2.0 percent of a vehicle's value to 0.65 percent of a vehicle's value. Here again, the state redirected property tax from schools to cities and counties to make up for the VLF cut and backfilled schools for the property tax loses with state funds.

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: The financing shifts and educational financing provisions are complex, and perhaps not entirely relevant to making a determination on this budget request. Some issues for consideration are the following:

- The funding shifts included revenue growth uncertainty and risk, as the relative growth of various revenue streams over many years was unknown. On a statewide basis, data suggests most counties have received a net benefit from the shifts.

- There was no backfill guaranteed in the original legislation, although the Alpine, Amador and San Mateo outcomes were also not anticipated. The enacting legislation did not include provisions for the state to backfill locals with new subventions if the baseline funding mechanism proved to be insufficient.

- At the time of the legislation, stakeholders were likely aware of the risk of variable levels of growth for different revenue streams, but may not have anticipated that outcome of all schools within the county becoming basic aid.

The overall approach to this issue has generally been ad hoc in nature, and a response to facts and circumstances. This would be of significant concern if the magnitude of the General Fund relief were to continue indefinitely or increase in magnitude. However, the DOF indicates that the unwinding of the Triple Flip should result in a general decrease in existing relief to counties and lessen the chances that the problem will extend to additional counties.

LAO Perspective: Previously, LAO has suggested that the state could reimburse cities and counties for all Triple Flip and VLF Swap funding shortfalls, as proposed in the Governor's budget or, in recognition of the significant fiscal benefits cities and counties receive under the VLF Swap, reimburse cities and counties only where necessary to replace actual sales tax and VLF revenue losses (what they would have received had they retained these revenue streams). Either level of reimbursement could be accomplished through the budget or through a shift in property taxes. The former approach would provide more revenue certainty for local governments while the latter would be more reflective of actual costs.

Staff Recommendation: Hold issue open, pending May Revision request.

Vote: