

# AGENDA

## ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION

**Assemblymember John Dutra, Chair**

TUESDAY, APRIL 20, 2004  
STATE CAPITOL, ROOM 447

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0965	CA INDUSTRIAL DEVELOPMENT FINANCING ADVISORY COMMISSION
0968	CA TAX CREDIT ALLOCATION COMMITTEE
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0985	CA SCHOOL FINANCE AUTHORITY
2310	OFFICE OF REAL ESTATE APPRAISERS
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## ITEMS TO BE HEARD

### ITEM 1100 CALIFORNIA SCIENCE CENTER

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The California Science Center is an educational, scientific and technological center administered by a nine-member board of directors appointed by the Governor. It is located in Exposition Park, a 160-acre tract just south of the central part of Los Angeles, which is owned by the State in the name of the Science Center. In a number of state-owned buildings, the Science Center presents a series of exhibits and conducts associated educational programs focusing on scientific and technological developments of the State. In addition, the Science Center, through the Park Manager, is responsible for maintenance of the park, public safety and parking facilities.

The budget proposes \$8.1 million General Fund for operational costs of the Science Center. Also, the budget proposes \$2.7 million General Fund for payment of lease revenue bonds for the facility.

#### ISSUE 1: LAO RECOMMENDATION: PHASE OUT STATE FUNDING FOR OPERATIONAL COSTS

The Governor's Budget proposes the continuation of \$8.1 million General Fund for the operation of the Science Center museum. Given the General Fund situation, the LAO believes it is appropriate to identify nonstate funding sources for the operational costs of the Science Center. Based on their review, the LAO believes that the charging of an admission fee, using private donations, and/or the use of revenues generated from the use of the state-owned facilities are appropriate funding sources.

The elimination of General Fund support for operation could be phased in over two years. Accordingly, the LAO recommends the deletion of \$5 million General Fund from the Science Center in the budget year. This action would maintain \$3.1 million General Fund for operational costs and \$2.7 million General Fund for the payment of the lease revenue bonds, which allows the Science Center to operate rent-free. To clarify the Legislature's intent, we also recommend the adoption of budget bill language as follows:

*"Item 1100-001-0001, Provision 1. It is the intent of the Legislature that the operations of the Science Center be funded entirely with nonstate funds beginning in 2005-06. The State will continue to provide for the payment of the center's lease revenue bonds."*

**Admission Fee Could Offset Costs.** In order to phase-out state funding for the Science Center, the LAO has recommended that revenue generated from the implementation of an entrance fee for the Center could help to allow the Center's operations to be reliant upon nonstate funds.

In their analysis, the LAO cites that over 1.3 million people (including 300,000 students) visit the Science Center each year. Currently, there is no charge for admission. Looking at similar institutions that charge admission fees, the LAO cites that the Exploratorium in San Francisco charges admission of \$12 for adults and \$8 for youths. The San Francisco Academy of Sciences charges admission of \$8 for adults and \$5 for youths. The LAO contends that even a

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fee of a lesser amount (with students admitted free) would provide several millions of dollars in funds for the operation of the Science Center.

**Science Center Concerns.** The Science Center has expressed concerns that the implementation of an entrance fee will have the following negative effects: 1) nominal net income; 2) decrease in attendance of 15 percent to 70 percent; 3) significant loss of audience diversity; 4) likely reductions in fundraising and donations; 5) likely reductions to earned income; 6) loss of parking revenue to the State of 15 percent to 70 percent.

Using the Chicago Museum of Science and Industry as a their model, the Science Center has projected that the introduction of an entrance fee would have the effect of a 15-70 percent decline in attendance, depending on the level of fee implemented. The Chicago Museum of Science and Industry was used as a comparison model because of its resemblance to the California Science Center in structure, funding and mission. In addition, after years of not charging an admission fee, in 1991 the Museum implemented an entrance fee for the general public and experienced a subsequent decline in attendance.

Based upon their analysis, the Science Center has projected that the implementation of a reasonable entrance fee would not provide additional operational revenue for the Center and would actually result in an earned income loss. This assumption is largely based on drops in attendance, drops in other Science Center revenue, increased need in advertising and costs associated with entrance fee implementation.

**Potentially Reduced Access for Underserved Populations.** Annually, 1.3 million people visit the Science Center with 300,000 coming with school groups. Currently there is no cost of admission; however, the Science Center does charge a \$6 parking fee.

The Science Center was designed to respond to the needs of diverse communities within the State. The absence of an entrance fee allows the Science Center to remain accessible to all communities throughout the State. The Science Center has raised concerns that the implementation of an entrance fee could drastically reduce accessibility for underserved populations in California, thus undermining the statutory mission of the Science Center.

**ISSUE 2: LAO OPTION: DELAY OPENING OF CENTER FOR SCIENCE LEARNING**

The Science Center School and Center for Science Learning are co-located and scheduled to open in July 2004. The elementary school will be operated and paid for by the Los Angeles Unified School District (LAUSD). The center, however, will be operated and paid for by the State at a cost of \$1.4 million General Fund. The goal is for the center to provide programming to enhance the school's focus on science. The LAO has presented as an option that the Legislature delay the opening of the center. The LAO further cites that the school could still open as planned (with more limited services available).

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**Staff Comments:** The Science Center has commented that the State signed into an agreement with LAUSD to open the Science Center Charter School and the Center for Science and Learning in the early 1990's. Subsequently, the State would have to break its contract with LAUSD in order to delay the opening of the Center for Science.

In addition, the Science Center Charter School and the Center for Science and Learning will be located in the same State building. Because the majority of the funding for this proposal will support the operational maintenance (janitorial services, general maintenance, etc.) of the building in which these two programs are co-located, not funding the proposal would affect both the Center for Science and Learning but also the LAUSD funded Charter School.

**ITEM 1700 DEPARTMENT OF FAIR EMPLOYMENT AND HOUSING**

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The Department of Fair Employment and Housing (DFEH) is the largest state civil rights agency in the country. It was established by the Legislature in 1959 as the Division of Fair Employment Practices and was initially part of the Department of Industrial Relations. The mission of the Department of Fair Employment and Housing is to protect the people of California from unlawful discrimination in employment, housing and public accommodations, and from the perpetration of acts of hate violence. DFEH has jurisdiction over both private and public entities operating within the State of California, including corporate entities, private sector contracts granted by the State of California, and all state departments and local governments.

**ISSUE 1: LAO OPTION: RETURN JOINT JURISDICTION CASES TO THE FEDERAL GOVERNMENT**

The LAO provided as an option to the Legislature for additional General Fund Savings that the DFEH return joint jurisdiction cases to the federal government. The LAO feels that subsequent staffing reductions due to decreased workload would result in \$8 million in General Fund Savings.

By agreement with the federal government, the department investigates complaints on behalf of the Equal Employment Opportunities Commission (EEOC) and the Department of Housing & Urban Development (HUD) when there is joint jurisdiction between federal and state law (approximately 70 percent of department cases). The EEOC and HUD reimburse the department for part of the investigation expenses (about one-third for most cases). The General Fund covers the remaining costs. The State could return to EEOC and HUD these joint jurisdiction cases instead of doing the federal government's work. As a result, the department would need fewer staff to handle remaining complaints that fall solely under state jurisdiction (medical condition, sexual orientation, and businesses with under 15 employees, for example).

**ITEM 2150 DEPARTMENT OF FINANCIAL INSTITUTIONS**

The Department of Financial Institutions (DFI) licenses and regulates several different types of entities to protect the funds entrusted by the public to these institutions. These entities include domestic banks, California branches of foreign banks, credit unions, issuers of money orders and travelers checks, and transmitters of money abroad. The DFI is supported by revenues from fees and assessments charged to regulated entities. Most of these fees are deposited in the Financial Institutions Fund and the Credit Union Fund.

**ISSUE 1: IMPLEMENTATION OF SB 1 (SPEIER)**

The budget proposes \$1.9 million and 17 positions for the department to implement and enforce Chapter 241. Chapter 241 establishes particular restrictions on the ability of businesses involved in financial-related transactions to share customer information. Chapter 241 affects the sharing of information with both a business' financial affiliates and independent (nonaffiliated) companies.

**Federal Law.** Federal law also governs the sharing of information between financial-related businesses. It generally allows states to adopt stricter measures than its own regarding sharing information with nonaffiliated companies. On the other hand, federal law generally preempts stricter state provisions regarding sharing information with affiliated companies. The federal affiliate provisions were due to expire on January 1, 2004. With these expiring provisions on the horizon, Chapter 241 was adopted in August 2003 and took effect in January 2004. Before Chapter 241 became effective, however, federal legislation permanently extended the preemption regarding affiliates. Chapter 241 includes provisions that are stronger than those in federal law for both affiliates and non-affiliates. As a result, there are many unresolved issues regarding the interaction between Chapter 241 and federal law.

**Staff Comments:** The department has stated that although there may be future conflicts with Federal law, it is the State's constitutional obligation to meet the full requirements of Chapter 241 until judicial precedence is set otherwise.

In prior fiscal analyses of Chapter 241, costs associated with implementing the bill were deemed "minimal." It is the understanding of Staff that these estimated implementation costs were to be approximately \$1 million. However, total funding requested for implementation is \$3.8 million (\$1.9 million - Department of Financial Institutions; \$1.9 million - Department of Corporations).

*The department should be prepared to respond to the increase in cost projection for the implementation of Chapter 241.*

**ITEM 2180 DEPARTMENT OF CORPORATIONS**

The Department of Corporations (DOC) is responsible for protecting the public from unfair business practices and fraudulent or improper sales of financial products and services. The department fulfills its responsibility through its investment and lender-fiduciary programs. The DOC is supported by license fees and regulatory assessments, which are deposited in the State Corporations Fund.

**ISSUE 1: IMPLEMENTATION OF SB 1 (SPEIER)**

The budget proposes \$1.9 million and 22 positions for the department to implement and enforce Chapter 241. Chapter 241 establishes particular restrictions on the ability of businesses involved in financial-related transactions to share customer information. Chapter 241 affects the sharing of information with both a business' financial affiliates and independent (nonaffiliated) companies.

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**ITEM 8260                      ARTS COUNCIL**

The California Arts Council was established by Chapter 1192, Statutes of 1975. Major statutory mandates to the Council are: (1) To encourage artistic awareness, participation, and expression among the citizens of California; (2) To help independent local groups develop their own arts programs; (3) To promote the employment of artists and those skilled in crafts in both the public and private sectors; (4) To provide for the exhibition of art works in public buildings throughout California; (5) To enlist the aid of all state agencies in the task of ensuring the fullest expression of our artistic potential.

The Council consists of eleven members, nine appointed by the Governor and one each by the President Pro-Tempore of the Senate and the Speaker of the Assembly. The Council establishes general policy and approves program allocations. Panels of experts, independent of the Council, advise the Council in each grant program. The Council stresses the development of community-based cultural activities in rural areas as well as in major metropolitan cultural centers. Almost all Arts Council grants programs require that the grantee provide, at a minimum, a match equal to the amount of the grant.

**ISSUE 1: LAO RECOMMENDATION: ELIMINATION OF GENERAL FUND SUPPORT**

In 2002-03, the department spent \$2.9 million (\$1.9 million General Fund) in state operation funds for 33 positions to administer over \$18 million (\$17.4 million General Fund) in local assistance programs and grants. Last year, the Legislature reduced the department's budget to \$3.1 million (\$1.1 million General Fund), resulting in the elimination of all local assistance activities.

Since it no longer operates local assistance programs, the department has been redefining its mission and focusing its efforts on administrative activities related to grants that had been authorized in prior years. In the current year, the number of staff was reduced to 19 positions, a 40 percent reduction. The budget proposes to continue the current-year staffing and funding levels.

The department reports that it is currently working on raising private donations to increase available funding. We believe this is an appropriate long-term funding source. No donations, however, have been collected yet.

The majority of the department's current workload is the administrative activities associated with grants provided to recipients in the past. The LAO believes this workload should be completed by the end of the current year and any other workload identified by the department could easily be paid for with its special and federal funds. Accordingly, because the work associated with past grants will be finished, the LAO recommends that the remaining General Fund support of \$1.1 million be deleted.



**ITEM 0950 STATE TREASURER**

The State Treasurer provides banking services to state government with goals to minimize interest and service costs and to maximize yield on investments. The Treasurer has custody of all monies and securities belonging to, or held in trust by, the state; invests state funds; and administers state bond sales and bond redemption and interest payments. The Treasurer also pays warrants drawn by the State Controller and other agencies, and oversees a number of financing entities.

The Treasurer's proposed budget totals \$21.6 million (\$5.8 million General Fund) in 2004-05. These amounts are the same as in the estimated amounts for current. The table below shows spending and staffing for the period from 2002-03 through 2004-05.

<b>State Treasurer Funding and Staffing Governor's Budget 2004-05</b> (Dollars in Thousands)				
	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>Percentage Change from 2003-04</b>
Investment Services	\$ 2,568	\$ 2,579	\$ 2,605	1.0%
Cash Management	6,815	7,305	7,294	-0.2%
Public Finance	6,748	5,682	5,672	-0.2%
Securities Management	4,000	4,087	4,082	-0.1%
Administration and Information Services	9,160	9,356	9,326	-0.3%
Distributed Administration	-7,487	-7,401	-7,371	-0.4%
State Mandated Local Programs	1	--	--	--
Total spending	\$ 21,805	\$ 21,608	\$ 21,608	--
General Fund	\$ 5,452	\$ 5,751	\$ 5,751	--
Reimbursements	\$ 16,353	\$ 15,857	\$ 15,857	--
Staffing (personnel-years)	225.2	222.8	222.8	--

The Treasurer's budget includes a funding shift of \$897,096 from the General Fund to reimbursements for services in both 2003-04 and 2004-05 as a result of a realignment of administrative costs. The budget also includes a reduction of 4 permanent positions and 2 temporary help positions as a result of Control Section 4.10 of the 2003 Budget Act.

**ISSUE 1: ECONOMIC RECOVERY BOND SALE—INFORMATIONAL****BACKGROUND**

At the March 2004 primary election, the voters approved Proposition 57, authorizing the sale of up to \$15 billion of Economic Recovery Bonds (ERBs) to finance the state's 2002-03 budget deficit and various deferred obligations. The state has pledged the revenue from a dedicated quarter-cent state sales tax to repay the bonds. However, under the "Triple Flip" mechanism,

the actual cost of debt service on the ERBs will be borne by the General Fund. (The bonds also have a back-up general obligation guarantee.) The Triple Flip provides for an offsetting suspension of a quarter cent of the local Bradley-Burns sales tax, with cities and counties made whole through a transfer of property tax revenue from K-14 education. The state, in turn, will make K-14 education whole through increased General Fund support under Proposition 98.

The budget allocates a total of \$12.3 billion of proceeds from ERBs. Of this amount, \$9.2 billion is used to finance the 2002-03 budget deficit (plus a small reserve of \$679 million) and \$3 billion to finance the 2004-05 budget deficit. A remaining amount of \$1.7 billion is reserved for financing various deferred obligations in 2005-06 or 2006-07. (The budget assumes total net proceeds of \$14 billion from the \$15 billion ERB authorization. The remaining \$1 billion would be available for issuance costs, establishing bond payment reserves, or providing credit enhancements.) The budget includes \$1.256 billion (GF) to cover debt service on the ERBs in 2004-05 (the funding is in K-14 education to replace property tax revenue under the Triple-Flip mechanism discussed above).

**Accelerated Bond Sales Announced.** On April 15<sup>th</sup>, the Treasurer announced an accelerated schedule for the sale of most of the bonds. The first sale of \$6 billion to \$7 billion will be priced on May 4<sup>th</sup> and sold over the following week. The second sale of \$5 billion to \$6 billion will occur between May 24 and June 15. The Treasurer cited strong market interest in the bonds, as well as a desire to take advantage of current low interest rates, in his announcement.

## COMMENTS

The Subcommittee may wish to ask the Treasurer to comment on the following points:

- Why did the Treasurer determine to sell these bonds on a negotiated, instead of bid, basis?
- How were the firms participating in the bond sale chosen?
- How will the bonds be structured?
- What will be the cost of issuance—will costs be less than the \$1 billion reserved by the budget?

## ISSUE 2: MANDATES

The Governor's Budget proposes to continue suspension of the following two state-mandated local programs (by providing a zero appropriation):

- **County Treasury Oversight Committees (Chapter 156, Statutes of 1996)** - Requires the establishment of a County Treasury Oversight Committee for any county that is investing surplus funds.
- **Investment Reports (Chapter 783, Statutes of 1995)** - This mandate requires the treasurer or chief fiscal officer of specified local agencies and school districts to render an annual statement of investment policy and a quarterly report on investments, containing specified information to the legislative body and oversight committee.

The budget proposal is consistent with the recommendations of the Assembly Special Committee on State Mandates. The committee also is proposing legislation to encourage local

governments to follow these practices, but remove the state mandate, eliminating state liability for cost reimbursement. The Legislative Analyst had previously recommended elimination of these mandates.

### COMMENTS

**Technical Amendment Needed.** Provisions 1 and 2 of the mandate item (0950-295-0001) should be deleted. They are standard provisions for mandate items that control expenditure of funds and allow augmentations in the case of deficiencies. They are inappropriate in this item, however, because no funds are appropriated and the mandates are suspended.

## ITEM 0991 CALIFORNIA FISCAL RECOVERY FINANCING AUTHORITY

The Governor's Budget includes Item 0991-001-3059 appropriating dedicated sales tax revenue to repay the Fiscal Recovery Bonds authorized by AB 7 X1 (Oropeza). The Economic Recovery Bonds authorized by Proposition 57 have now replaced those bonds. Debt service for the Proposition 57 bonds is continuously appropriated. Consequently, this item is now obsolete and should be deleted.

**Staff Recommendation: Delete item.**

## ITEM 8770 ELECTRICITY OVERSIGHT BOARD

The Electricity Oversight Board (EOB) is part of the regulatory oversight structure that was established by the legislation restructuring California's electricity industry in 1996. The board is charged with ensuring the reliability of the electricity transmission system and in the power market.

The Budget proposes total expenditures of \$3.6 million (from special funds that support the Public Utilities Commission and the Energy Commission) and 21.9 personnel-years of staff. The request represents a slight reduction compared with the current year due to the expenditure of \$240,000 in one-time General Fund support in the current year.

### ISSUE 1: ROLE OF EOB REMAINS UNCLEAR

The original purpose of the EOB was to oversee the now-defunct Power Exchange and the Independent System Operator (ISO). Those functions, as currently laid out in statute, have

essentially disappeared. The EOB's de facto role now is as an advocate on behalf of the state before the Federal Energy Regulatory Commission (FERC) and the courts in concert with several other state agencies, and in advising the administration regarding electricity market issues.

**The EOB indicates that its activities for 2004-05 will include the following:**

- Continued pursuit of refunds before FERC for energy market overcharges in 2000-01.
- Litigation and negotiation to reform the state's long-term energy contracts.
- Defending the state's authority in the governance of the ISO.
- Redesign of the California Electricity market, including changes in ISO operating standards.
- Regional market monitoring.

<b>COMMENTS</b>
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The permanent role and future form of the EOB (if any) are likely to depend on legislation to restructure the state's energy agencies and/or federal actions affecting the structure of the energy market.

**Report on State's Efforts before FERC.** The 2003 Budget Act requires the EOB to report on the state's activities before FERC by March 1, 2004. The report shall describe the roles of each state agency, how policies and objectives are determined, and identify mechanisms to coordinate action.

- The EOB should indicate the status of this report.

## **ITEM 9100 TAX RELIEF**

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The state provides tax relief—both as subventions to local governments and as direct payments to eligible taxpayers—through a number of programs contained within this budget item. These are distinct from "tax expenditures," such as tax deductions, exemptions, and credits, which reduce tax liability. Some of the tax relief expenditures in this item, however, are amounts paid to local governments to offset some or all of their revenue loss due to a tax expenditure.

The budget proposes total 2003-04 tax relief of \$4.7 billion, of which \$668 million is appropriated in the budget bill. The remaining \$4.1 billion is continuously appropriated for the Vehicle License Fee (VLF) "backfill," which is distributed to localities and budgeted through a continuous appropriation.

After the VLF backfill, the second largest tax relief program shown in the budget is the homeowners' exemption (\$433 million). This program, which is required by the State Constitution, grants a \$7,000 property tax exemption on the assessed value of owner-occupied dwellings, and requires the state to reimburse local governments for the resulting reduction in property tax revenues. The exemption reduces the typical homeowner's taxes by about \$75 annually. In order to accommodate the expected growth in the number of homeowners claiming the exemption, the Governor's budget proposes an increase of \$5.6 million, or 1.3 percent, over the amount budgeted for 2002-03. Senior Citizens' Property Tax and Renters' Assistance (\$183.4 million) provides once-a-year assistance checks to low-income seniors and disabled persons who either own a home or rent a dwelling in California.

### ISSUE 1: WILLIAMSON ACT OPEN SPACE SUBVENTIONS

The budget proposes a General Fund appropriation of \$39.8 million for subventions that partially reimburse local governments (primarily counties) for property tax losses under Williamson Act Open Space contracts.

**LAO Recommends Phase-Out.** The Legislative Analyst's Office recommends reducing 10-percent of the subvention amounts each year. Under this approach the General Fund savings would be about \$4 million in 2004-05 and gradually increase to the full \$39.8 million (plus growth) over ten years.

### BACKGROUND

The Williamson Act allows cities and counties to enter into contracts with landowners to restrict their property to open space and agricultural use. In return for the restriction, the property owner pays reduced property taxes because the land is assessed at lower than the maximum level. The amount of the state subvention to localities is based on the acreage and classification of land under contract, rather than the actual reduction in local property tax revenues.

The contracts entered into between local governments and property owners are rolling ten-year contracts (20 years in a Farmland Security Zone) that are typically renewed each year for an additional year. In the event the contract is not renewed, the tax on the property gradually returns over a ten-year period to the level at which comparable, but unrestricted, land is taxed.

Williamson Act contracts exist in 52 counties and seven cities and cover more than 16.3 million acres of land. Subventions range from \$1 per acre for nonprime agricultural land outside of a Farmland Security Zone to \$8 per acre for land within three miles of a city's sphere of influence in a Farmland Security Zone. The counties receiving the largest amount of subventions are Fresno and Kern (more than \$5 million each).

**Proposition 13 Undermined Original Rationale for Program.** Prior to Proposition 13, property was regularly reassessed at its current market value. As development encroached on farmland, its assessed value rose based on its development potential. In some cases, property tax bills rose to a point where farming was no longer economical and farmers were forced to sell out to developers. The Williamson Act allowed landowners to agree to maintain their land in farming or open space in exchange for limiting assessed values to the land's agricultural value. Under Proposition 13, however, increased development potential does not result in a

reassessment unless the land is sold and that higher value is reflected in the sale price. In most cases, the program now serves as a form of property tax relief to agriculture and rural landowners.

However, the program continues to provide some open-space protection because of the creation of agricultural preserves by local governments and because open-space contracts restrict development for at least 10 years.

#### COMMENTS:

- **Total Annual State Costs of \$80 million.** The tax relief subventions are only one part of the state's financial participation in the Williamson Act. According to the LAO, the General Fund also spends more than \$40 million annually to backfill public schools for their property tax revenue losses through Proposition 98 and other school financing mechanisms. The total state cost of the program, therefore, is on the order of \$80 million annually.
- **How Cost Effective?** Most of the land under contract is not under imminent threat of development. Furthermore, the property tax reduction is proportionately least for land that is bought and sold based solely on its agricultural value. The highest percentage reductions go to landowners that purchase land for much more than its purely agricultural value—for example, foothill ranches whose aesthetic value far exceeds their value for grazing or timber. Although the state may have an interest in maintaining such land in open space, it is not clear whether the property tax benefit provided by the Williamson Act serves more as an incentive or a windfall in these cases.

#### ISSUE 2: VLF "POISON PILL" – WHERE IS THE ANTIDOTE?

**Realignment and VLF.** The Governor's Budget proposes Trailer Bill Language to repeal the VLF Poison Pill. (AB 5 X5, McCarthy, would accomplish this.) This proposal is consistent with the budget's assumption of full funding of State-Local Realignment in 2004-05. The 1991 Realignment of various state health and social services programs and funding responsibilities to counties was funded by a combination of sales tax and VLF revenues. The sales tax funding was from a dedicated half-cent increase in the state sales tax. The VLF revenues were provided through slowing the depreciation schedule that determines the value of vehicles on which the VLF is assessed. The VLF depreciation change now produces annual revenue of \$1.5 billion for Realignment (out of a total of about \$4 billion). As a result of the reduction in the VLF rate, actual VLF revenues now account for about \$500 million of VLF Realignment funding, and General Fund backfill provides the remaining \$1 billion.

**The Poison Pill.** At the time that Realignment was established, counties were asserting that the shift of the Medically Indigent Adult (MIA) program to them (from the Medi-Cal Program) in 1982 constituted a state-mandated local program for which they were entitled to reimbursement. The potential state exposure, should those claims prove successful, was thought to be large. Realignment, along with other actions, was intended, in part, to help support county funding for health programs. As a protective measure, the Legislature included a provision in the

Realignment legislation that repeals the VLF depreciation schedule and the authority to allocate VLF (now including backfill) revenues to Realignment (via the Local Revenue Fund) in the event that the courts determined that the 1982 MIA shift was a reimbursable mandate.

**Poison Pill Activated.** As it turned out, only one county--San Diego-- successfully asserted an MIA mandate claim, and that only for one year and \$3.4 million. However, San Diego County's claim has triggered the Poison Pill provision (the state's final appeal to the California Supreme Court was refused in December 2003). The Department of Motor Vehicles has issued emergency regulations temporarily extending the realignment depreciation schedule pending creation of a revised schedule. However, there is no longer statutory authority for the Controller to allocate VLF revenue or backfill to Realignment. Instead, all VLF revenue and backfill will be transferred to the Motor Vehicle License Fee Account and allocated to cities and counties primarily on a per-capita basis.

**Suicide Pact.** The MIA Poison Pill will make the state just as sick as the counties. In the absence of VLF Realignment funding, counties will have unfunded mandates for the programs that Realignment requires them to carry out. They will then claim reimbursement from the state General Fund for their unfunded mandates. Some counties may refuse, or simply be unable, to carry out all of their Realignment programs without this funding. A final determination of an unfunded mandate for Realignment itself will activate another poison pill provision that repeals the sales tax for Realignment. Eventually, after considerable disruption, the state would have to restore Realignment funding or take back the programs and costs that it transferred to counties in 1991.

**Legislation Urgently Needed.** AB 1457 (Committee on Budget) would restore the Controller's authority to fund the VLF portion of Realignment. However, this is a stopgap measure because it will not provide an ongoing statutory basis for the existing VLF depreciation schedule, putting \$500 million of annual VLF Realignment funding at risk unless the poison pill is fully repealed.

### ISSUE 3: REPEAL OF HISTORICALLY SUSPENDED MANDATES

The Governor's Budget proposes repeal of the following two state-mandated local programs that have been suspended the annual Budget Act for a number of years.

- Property Tax-Family Transfers (Chapter 48, Statutes of 1987)--Requires county assessors to provide quarterly reports to the Board of Equalization on specified property purchases and transfers made after November 6, 1986.
- Senior Citizens' Mobile Home Property Tax Deferral (Chapter 1051, Statutes of 1993)-- Requires assessors, tax collectors, and recorders to file certificates of eligibility with the State Controller that establish liens, record tax postponement information, and disseminate that information to all interested parties. Also requires county officials to notify the SCO of any changes in ownership of affected mobile homes.

The repeal of these mandates will eliminate the need to include a suspension item in the annual Budget Act, and will revise the underlying statutes to make it clear that the mandates no longer

apply. This action would be consistent with the recommendations of the Special Committee on State Mandates and the LAO.

#### ISSUE 4: SUBSTANDARD HOUSING

The Governor's Budget proposes adoption of Trailer Bill Language to eliminate certain allocations to cities and counties for the enforcement of housing codes and rehabilitation. Existing state tax laws deny taxpayers deductions associated with rental income from substandard housing. The revenue from the denied deductions is allocated to the local governments in which the substandard housing is located.

The amount allocated has been very small—only \$44,000 in 2002-03 and 2003-04 according to the budget. The state and local governments also incur some administrative costs related to these allocations. Consequently, ending these allocations should not have any significant net effect.

#### ITEM 9210 LOCAL GOVERNMENT FINANCING

Local Government Financing (Excluding Public Safety and Juvenile Justice Funding) General Fund (Dollars in Thousands)					
				Change from 2003-04	
	2002-03	2003-04	2004-05	Amount	Percent
Property tax administration	\$51,500	\$60,000	\$60,000	\$--	--%
Booking fee subventions	38,220	38,220	0	-38,220	-100%
State mandated costs	3	3	5	--	--
Supplemental subventions to redevelopment agencies	600	700	--	-700	-100%
Supplemental subventions to counties with no cities	147	147	0	-147	-100%
<b>Totals</b>	<b>\$90,470</b>	<b>\$99,070</b>	<b>\$65,005</b>	<b>-\$34,065</b>	<b>-34.4%</b>

This item includes the following local government funding:

1. **Property tax administration grants.** The budget proposes \$60 million in 2004-05 to continue the property tax administration grant program. This program previously was a loan program for counties in which the state forgave loans to counties that used the funds to generate additional property tax revenue to their public schools (resulting in state savings in education funding) that exceeded the loan amount. AB 589 (Wesson) of 2001 extended the program through 2006-07 and changed it to a grant program. Counties must apply for the grants, use them to augment their property tax assessment and administration functions, and provide reports to the state.



2. **Booking fee subventions.** The budget proposes to eliminate these subventions to cities in 2004-05, along with counties' authority to charge booking fees to cities. Current law continuously appropriates \$38.2 million annually for these subventions (discussed in Issue 2 below).
3. **State mandated costs.** The budget proposes to continue deferral of mandated cost payments for three local mandates funded in this item, defer payments for two new mandates and to repeal five long-suspended mandates. Token appropriations of \$1,000 are provided to continue the six deferred mandates (discussed in Issue 3 below).
4. **Supplemental subventions to redevelopment agencies.** The 2003-04 Budget eliminated additional appropriations for these subventions that have been made to a few redevelopment agencies that historically relied disproportionately on former state supplemental subventions. The \$700,000 of funding shown for the current year is a carryover from a prior appropriation.
5. **Supplemental subventions to counties without cities.** These subventions are provided on a population basis to several small counties that have no incorporated cities. Local government as a whole receives a lower level of Vehicle License Fee revenue in these counties because they receive no city allocations. These supplemental subventions partially compensate for this disparity. The Governor's Budget proposes to end these subventions. (See Issue 4 below.)

Local COPS and Juvenile Justice grants also are funded in this item, but will be addressed separately.

### **ISSUE 1: ADDITIONAL \$1.3 BILLION ERAF SHIFT—INFORMATIONAL OVERVIEW OF PROPOSAL AND ALTERNATIVES**

Although it does not directly affect Item 9210, the Governor's most significant local government budget proposal is a \$1.3 billion additional property tax shift. This would be accomplished by Trailer Bill legislation, while the resulting General Fund savings would manifest itself as a reduction in spending on K-14 education. However, K-14 *total* funding would be unaffected because the General Fund reduction would be limited to the additional property tax revenue that schools and community colleges would receive from local government entities under the shift.

#### **Budget Proposal**

The Governor's Budget assumes \$1.3 billion of General Fund savings in 2004-05 from a proposed ongoing annual increase in the property tax shift from local governments to K-14 education. This shift takes place via the Educational Revenue Augmentation Fund (ERAF) in each county and reduces on a dollar-for-dollar basis the state's General Fund obligation to K-14 education under Proposition 98. The proposal has been characterized as resulting in the following property tax revenue losses:

<b>Governor's Budget</b>	
<b>Proposed 2004-05 Local Government Property Tax Shift</b>	
(Dollars in Millions)	
Counties	\$909
Cities	188
Redevelopment agencies	135
Special districts	105
<b>Total</b>	<b>\$1,336</b>
Detail does not add due to rounding.	

The administration indicates that this proposal is intended as a permanent ongoing equivalent to the \$1.3 billion of VLF gap funding shortfall to local government in the current year. However, this additional ERAF shift will not be repaid to local governments, and the impact will fall more heavily on counties and less heavily on cities, compared with the VLF gap impacts. Moreover, the additional ERAF shift would redirect \$135 million from redevelopment agencies and \$105 million from special districts, neither of which receive VLF funding or were affected by the VLF gap. (The 2003-04 Budget does include a one-time \$135 million ERAF contribution from redevelopment agencies.)

The administration has indicated that its primary goal in making this proposal is to achieve the budgeted amount of savings and that it is open to discussion on the specific mechanism of the savings and the allocation of revenue losses or costs among local government entities.

### **Objections to the Proposal**

The Legislative Analyst's Office (LAO) has recommended against adoption of the proposal and local governments have strongly objected to it. The LAO, for example, raises the following concerns:

- The proposal merely transfers part of the state's budget problem to local government.
- The property tax shift would continue to use the same formulas used for previously enacted shifts in the 1990s, which in turn were based on property tax allocations from the 1970s. This approach no longer makes sense.
- The impact on counties is especially large, although counties have very limited amounts of other discretionary revenue. Significant reductions in county funding would require reductions in public safety, justice, health care, and social services programs because these are in the areas in which counties generally spend the most money.
- Shifting additional property tax revenue away from cities and counties will further increase their dependence on sales tax. This will further exacerbate the existing fiscal incentives for local governments to chase retail development to the detriment of housing and other necessary land uses.
- The diversion of more property tax from cities would provide an incentive for them to further expand their redevelopment project areas. With very little regular property tax revenue left, cities could benefit even more by using redevelopment to capture future property tax growth within their boundaries.

### Alternative Proposals

**LAO.** Although the LAO recommends against the Governor's proposal, they present an alternative in the event that \$1.3 billion of budget savings from local government must be achieved. The LAO alternative is summarized in the table below.

<b>LAO Alternative to Governor's \$1.3 Billion ERAF Shift</b>	
<b>(In Millions)</b>	
Reduce restricted subventions—eliminate COP, Juvenile Justice Challenge Grants, and Library grants	\$216
Special districts—ERAF shift allocated by state on a county basis, then allocated by Boards of Supervisors to districts within each county	400
Redevelopment agencies—ERAF shift targeted at agencies with the most aggressive practices	320
Cities—sales tax shift to state, partially offset by VLF reallocation from counties	200
Counties—sales tax shift to state and VLF reallocation to cities	<u>200</u>
<b>Total State Fiscal Relief</b>	<b>\$1,336</b>

#### Key Features of the LAO Alternative:

- Reduces loss of general-purpose revenues.
- Moves toward more balance in fiscal incentives for land use decisions.
  - No loss of property tax to cities or counties.
  - Less dependence on sales tax.
- Encourages local decision-making.
- Same ongoing state savings as for the Governor's proposal.

**California State Association of Counties (CSAC).** The counties have proposed their own alternative to the Governor's ERAF shift. Under the CSAC alternative, counties, cities, special districts and redevelopment agencies each would provide a *one-time* grant to the state of \$200 million in 2004-05 with local discretion over the source of funds and the \$16 million state grant program to libraries would be suspended. The total state savings would be \$816 million—about \$500 million less than the Governor's proposal, and it would be limited to 2004-05. Furthermore, the alternative lacks a mechanism by which the state could enforce the local contributions.

**VLF Backfill Swap.** Another idea that the administration has begun to explore is to modify its budget proposal by eliminating VLF backfill payments to cities and counties, but *partially* replacing the local revenue loss with additional property tax revenue diverted from K-14 education. The net state savings would be the difference between the \$4.1 billion VLF backfill savings and the state cost of offsetting the property tax loss to K-14 education.

**Ballot Proposals.** Local governments are seeking constitutional changes to protect them from state diversion of their traditional revenues as well as the unfunded mandate costs. CSAC and the League of California Cities have gathered signatures for an initiative (the Local Taxpayers and Public Safety Protection Act) and Assembly Member Steinberg, working with former Speaker Hertzberg, Assembly Member Campbell and others also have developed an alternative ballot approach.

	<b>Local Taxpayers and Public Safety Protection Act</b>	<b>Local Government Property Tax Protection Act (Steinberg et al.)</b>
<b>Applies to:</b>	Counties, cities, special districts and redevelopment agencies.	Counties, cities and special districts.
<b>Constitutionally protected local tax revenue</b>	Property tax, local sales tax, VLF and backfill, VLF gap loan, sales tax swapped in Triple Flip.	Property tax, local sales tax, business license tax, transient occupancy tax, utility users tax.
<b>Prohibitions on Legislature</b>	Reducing, redirecting, shifting to an ERAF-like fund, or delaying receipt, reallocating the sales tax, or reallocating the property tax without the consent of the affected local governments.	Reducing, suspending, delaying receipt, appropriating, reallocating, or redistributing the funds.
<b>Revenue Swap</b>	None.	Swaps half-cent of local sales tax and VLF revenue (excluding Realignment) for property tax from schools in order to reform incentives for land-use decisions.

Both approaches also enable local governments to cease complying with some unfunded mandates.

**CSAC/League Measure Would Undo Budget ERAF Shift.** The revenue protections in the Local Taxpayers and Public Safety Protection Act initiative would be retroactive to November 2003. Consequently, the Governor's \$1.3 billion ERAF shift (if adopted in the budget) would be reversed if voters approve the ballot measure.

**ISSUE 2: BOOKING FEE SUBVENTIONS**

The Governor's Budget proposes Trailer Bill Language to (1) eliminate reimbursements to 373 cities and special districts that are based on jail booking fees they paid to counties in 1997-98 for an annual General Fund savings of \$38.2 million and (2) repeal counties' authority to charge booking fees.

**BACKGROUND:**

Chapter 466, Statutes of 1990 (SB 2557, Maddy) gave counties the ability to charge cities and special districts a booking fee each time an individual was booked into the county jail. While giving counties a new revenue source, the payment of booking fees also provides a fiscal incentive for police departments to avoid unnecessary bookings. Beginning with the 1999-00 budget, local governments have been annually reimbursed for the booking fees they paid in 1997-98. Eliminating the booking fee reimbursements, therefore, would affect those cities and special districts that paid booking fees in 1997-98. However, the loss to those cities and special districts would be offset (more or less) by being relieved of any requirement to pay booking fees. For that reason, the primary impact of this proposal would be a loss of booking fee revenue to counties.

**COMMENTS:**

**LAO Recommends Retaining Booking Fees But Eliminating Subventions.** The LAO contends that booking fees encourage local agencies to use county booking and detention services efficiently and that it is appropriate for cities and special districts to pay for the costs that they impose on counties.

**Impact on Counties Could be Larger.** The California State Association of Counties (CSAC) surveyed its members and found that they receive about \$37 million in booking fees annually. However, the impact on counties from the elimination of booking fee authority could be larger than this amount. This is because cities and districts probably would increase their booking activity in the absence of these charges.

**Frozen in Time.** The subvention amounts and recipients are frozen based on the situation in 1997-98. The subventions do not necessarily relate to any current booking fee costs. Instead, they are general revenue to the recipient cities that may or may not relate to their current costs for booking fees. LAO points out that cities in Orange County (Garden Grove and Santa Ana, for example) continue to receive booking fee subventions even though Orange County no longer charges booking fees.

▪ **The following cities receiving the largest subventions:**

- San Diego                      \$5.2 million
- Sacramento                    \$2.1 million
- Fresno                            \$1.1 million
- Stockton                         \$1 million
- Bakersfield                    \$0.7 million
- San Bernardino                \$0.7 million
- Santa Rosa                      \$0.7 million
- Riverside                        \$0.6 million
- Oceanside                       \$0.5 million

<b>ISSUE 3: STATE MANDATES</b>
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**Repeal Proposals.** The budget proposes to repeal the following long-suspended mandates:

<b>CPR Pocket Masks</b> - Every officer shall have a CPR pocket mask.
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<b>Domestic Violence Information</b> (Ch. 1609/84)--Requires law enforcement agencies to develop, adopt, and implement written policies and standards for peace officers responding to incidents involving domestic violence.
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<b>Filipino Employee Surveys</b> (Ch. 845/78)--Requires in certain instances that Filipino employees be categorized as such in employee ethnicity surveys and tabulations.
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<b>Involuntary Lien Notices</b> (Ch. 1281/80)--Requires the county recorder to notify debtors of involuntary liens. When the lienor is a governmental entity, the county cannot charge a notification fee.
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<b>Lis Pendens</b> (Ch. 889/81)--Requires counties to prepare and record a notice of the pendency of an action involving real property or the title or the right of possession of real property.
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<b>Proration of Fines and Court Audits</b> (Ch. 980/84)--Requires each fine, penalty, forfeiture, and fee to be prorated among State and local entities and requires county auditors to conduct biennial audits. Also requires county auditors to review collection and disbursement activities of probation offices and central collection bureaus, and requires a certified copy of the associated audit to be submitted to the SCO.
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Repeal of these mandates is consistent with the recommendations of the Special Committee on State Mandates.

**LAO Recommendations for Repeal.** The LAO recommends repeal of the following mandates that the budget proposes to maintain but defer payment: Generally, the Special Committee on State Mandates has recommended continuation with payment deferral for these mandates. However, the Special Committee also has noted that some claiming guidelines should be tightened.

**Health Benefits for Survivors of Peace Officers and Firefighters** (Ch 1120/96)--This benefit was provided in 2002 and would probably be considered a vested right. This is a new mandate that has not yet been funded.

**Brown Act Reform** (Ch. 1137, 1137, and 1138/93 and Chapter 32/94) —Expands requirement of act to include additional local committees and advisory bodies.

**Photographic Record of Evidence**--First-year costs in 2002-03 of \$2.6 million, ongoing costs of \$265,000. \$332,000 average. This is a new mandate that has not yet been funded.

#### COMMENTS:

The Department of Finance and the LAO should explain their mandate proposals and recommendations to the subcommittee and also explain where they differ from the recommendations of the Special Committee on State Mandates.

#### ISSUE 4: SUBVENTIONS TO COUNTIES WITH NO CITIES

These subventions are provided on a population basis to several small counties that have no incorporated cities. These counties as a whole receive a lower level of Vehicle License Fee revenue in these counties, compared with most counties, because they receive no city allocations. These supplemental subventions partially compensate for this disparity. The Governor's Budget proposes to end these subventions for a General Fund savings of \$147,000.

#### ISSUE 5: COPS - JUVENILE JUSTICE

Chapter 134, Statutes of 1996 (AB 3229, Brulte), established the Citizens' Option for Public Safety (COPS) which provided \$100 million from the General Fund to local public safety entities including police (75 percent) and sheriff departments (12.5 percent) and district attorneys (12.5 percent). Chapter 289, Statutes of 1997 (AB 1584, Prenter) extended the program through the 1999-2000 fiscal year. Chapter 353, Statutes of 2000 (AB 1913 Cardenas) expanded the program to include support for juvenile justice grants. The 2001-02 and 2002-03 Budget Acts appropriated \$232.6 million for these programs in each year.

For 2004-05, the Governor's Budget proposes funding of \$200 million for the COPS/Juvenile Justice Grants. This is similar to the amount appropriated in the current year.

**COMMENTS**

The Governor's Budget proposes the phasing out of TANF funds to local probation programs. This would result in a reduction of funding of \$134 million in 2004-05 growing to \$201 million in 2005-06 and future years. This issue is scheduled for hearing on May 5, 2004 in Assembly Budget Subcommittee #1. The Legislative Analyst 's Office has recommended that the State consider alternatives to the reduction of TANF funding to probation programs that include the elimination or suspension of the COPS/ Juvenile Justice grant programs.