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TO: City Managers
FROM: Chris McKenzie, Executive Director
DATE: April 7, 2009 (Updated 2:30 p.m.)
SUBJECT: Background on League Support of Propositions 1A-1F

I am writing you to provide background on the decision by the League's board of directors yesterday, by a three-to-one margin, to support Propositions 1A-F that will appear on the May 19 statewide special election ballot. The board's decision followed a long debate and almost identical approval vote margin by the League's Revenue and Taxation Policy Committee last Friday. The board concluded that this action is of critical importance to protecting city revenues, furthering infrastructure investment, and rebuilding our state and local economies.

In supporting these propositions, the League has joined a bipartisan coalition of taxpayer groups (California Taxpayers Association, Orange County Taxpayers Association), business groups (California State Chamber, California Business Roundtable, California Manufacturers and Technology Association, California Retailers Association, etc.), public safety groups (police chiefs, fire chiefs, sheriffs, PORAC, etc.), and many others.

Those of you who remember the pain of the 15 years of ongoing and increasing ERAF property tax shifts between 1991 and 2006 know that the League's first, second and third priority is to protect city revenues. This includes ensuring that your state shared revenues, including transportation funds, are not interrupted. The cold reality is that city revenues are more vulnerable to being taken or "borrowed" by the state when it experiences a financial crisis. We were successful in fending off state revenue grabs during the most recent budget negotiations because of Prop. 1A (2004) and because state leaders decided to balance the budget with state budget cuts and state revenue increases.

The League board concluded that this new Prop. 1A offers the prospect for long-term fiscal reform and stability for state government as the new, less vulnerable, state rainy day fund is filled over the years. The reality is that the state's periodic revenue windfalls still get spent almost as fast as they are received, putting city revenues immediately at risk during the subsequent budget "crisis." The 2009 Prop. 1A will make that much more difficult and ensure that if it is spent down it happens to make investments in infrastructure and state debt reduction.

Since the legislative deal that put 2004 Prop. 1A on the ballot to protect local revenues, we have enjoyed considerable success in protecting local funds. City officials deserve considerable credit for that, but the state official who has been our principle partner in defeating efforts to "borrow" local funds has been the Governor. He has repeatedly stood

up for cities in this regard. What is not widely known, however, is that the Governor has also vetoed countless other pieces of legislation at our request that would have reduced local revenues or harmed local control. We will be asking him to do the same thing numerous times over the next two years.

Last Friday, the Governor sent the attached letter to city officials outlining his views on our partnership to protect local revenues. In his letter he renews his commitment, but he also asks us to support the May 19 propositions to ensure that this is possible. If these measures fail, there will be an immediate \$7 billion hole in the state budget on top of the \$8 billion already estimated by the LAO. This \$15 billion hole could plunge the state legislature into further partisan gridlock and send the state again to the verge of if not into insolvency. That will put local revenues immediately at risk.

The League board also voted to support Props. 1A-F because we can't afford to stop our state and local infrastructure projects at a time when jobs and capital investment are essential to our economic recovery. Just yesterday, the state Pooled Money Investment Board approved temporary funding to proceed with just **500 of 5,400** important infrastructure projects around the state because of the cash crisis still facing the state. If Props. 1A-F fail, it will only deepen the state's cash crisis and many of these projects will likely come to a halt just at the time when our economy and budgets can least afford it.

In addition to the letter from the Governor, I also have attached an informative staff report to the League's Revenue and Taxation Policy Committee, prepared by League Legislative Director Dan Carrigg. It contains the staff recommendation of support. This report was shared with the League board of directors.

Please let me know if you have any questions. I look forward to seeing many of you at Legislative Action Days next week in Sacramento where we have a great line-up of speakers, including Gov. Schwarzenegger, and an outstanding panel on state governance reform.



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April 7, 2009

Contact: Eva Spiegel, (916) 658-8228

FOR IMMEDIATE RELEASE

League of California Cities Board Supports Propositions 1A-F

Sacramento, CA — The League of California Cities board of directors on Monday, April 6, took formal action to support Propositions 1A-1F on the May 19 statewide special election ballot. These measures are supported by a broad coalition of prominent statewide business, taxpayer and public safety groups as well as a bipartisan group of current and former state and local elected officials.

The board action came after the League's Revenue and Taxation Policy Committee recommended support last week by a three-to-one margin. The League's board consists of 43 elected and 10 appointed city officials. Three-fourths of the votes cast by board members supported the board's action.

The League's leadership made the following statements on the organization's support of Props. 1A-F:

League President Judy Mitchell, mayor, Rolling Hills Estates, endorsed the action, praising her colleagues. "Our board had a very spirited and respectful debate, representative I suspect of the one that is going on across California. As city officials, our most important job on state financial matters is to protect local government revenues. The difficult decision to support these ballot measures reflects our conviction as city leaders that the short-term and long-term interests of cities and the entire state will be better served if these measures pass," said Mitchell.

"Cities have long maintained that the state should face up to its fiscal challenges by making the tough choices required to balance the state budget with state funds rather than irresponsibly taking or 'borrowing' local funds needed for vital community services. These ballot measures and the budget they implement represent a bipartisan effort that reflects this philosophy at a time when city services are already being cut deeply due to the recession," continued Mitchell.

Ken Cooley, League first vice president and vice mayor, Rancho Cordova, observed: "These ballot measures reflect solid, bipartisan progress to achieve state budget reform and greater financial stability for our state. For me, the bottom line is that ultimately city public safety, transportation and other essential local services will be more stable if the state's finances are more predictable. That is why I believe it's critical to support these ballot measures."

League Second Vice President and Hemet Council Member Robin Lowe underscored the infrastructure and economic benefits of the plan during this time of economic recession. "We simply can't afford another state cash crisis that stops critically needed infrastructure projects dead in their tracks. These badly needed construction projects create valuable jobs and address serious needs in our communities that will provide long-term economic benefits for cities and our state."

Established in 1898, the League of California Cities is a nonprofit statewide association that advocates for cities with the state and federal governments and provides education and training services to elected and appointed city officials.

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GOVERNOR ARNOLD SCHWARZENEGGER

April 2, 2009

Dear City Official:

In 2004 we made history when 84% of the voters passed Proposition 1A to protect local revenues from being raided by Sacramento. We partnered again in 2006 to pass another Proposition 1A to protect transportation funding from state raids. These two constitutional amendments were historic, and they laid the groundwork for more fiscal reforms to hold state government accountable and force Sacramento to live within its means.

Since 2004 I also have worked with you to block fiscally irresponsible efforts by the Legislature to borrow local property tax and transportation funds instead of making tough decisions. I told legislators "no" because that kind of action would have only kicked our problem into future years and harmed vital city services. For five years I have been proud to be your partner in protecting local and transportation revenues from being used to finance other state priorities, and I believe our partnership is even more important today than ever before.

I am writing you today to ask your help in passing a new Proposition 1A on the May 19th statewide ballot to complement the 2004 and 2006 measures and to continue the job of state fiscal reform. Proposition 1A will change the constitution to limit and stabilize state spending, provide a rainy day fund to help soften the impacts of future financial crises, and prohibit committing one-time state revenues to long-term programs. If Proposition 1A had been in place over the last 10 years, we would have had \$9 billion in the rainy day reserve fund this year to help us avoid the deepest of budget cuts and tax increases.

Proposition 1A is accompanied by five other measures (Props. 1B, 1C, 1D, 1E and 1F) that will help the state balance the budget. Their passage is critical to the success of Proposition 1A, and they will help avoid draconian cuts and other drastic steps that will certainly be necessary if they do not pass.

I have been proud to be your partner in these efforts to protect local government services and funds, but our job is not done until the state becomes more fiscally prudent and stops using one-time revenues for long-term spending commitments. We need to pass Propositions 1A through 1F in order to constrain future spending and to make it through our current difficult budget crisis. Together these measures will help us assure the state lives within its means and is not tempted to fund state government programs by borrowing or taking local funds.

Please join me in continuing the job of state fiscal reform that we started in 2004 by supporting Propositions 1A through 1F on the May 19 statewide ballot.

Sincerely,

A handwritten signature in black ink, appearing to read "Arnold Schwarzenegger".

Arnold Schwarzenegger

**LEAGUE OF CALIFORNIA CITIES
COMMITTEE ON REVENUE AND TAXATION
April 3, 2009 – Action Item**

Staff: Lobbyist: Dan Carrigg, Legislative Director (916-658-8222)

Proposition 1A, Rainy Day Budget Stabilization Fund

Policy Questions:

- Proposition 1A, a state budget and fiscal reform measure, is the central component in a package of six measures approved by the Legislature and signed by the Governor on February 20, 2009, for placement in a May 19, 2009, Special Election. While the other measures placed on this ballot – Propositions 1B through 1F – are also important, the voter’s decision on Proposition 1A will have the broadest impact. What are the policy ramifications should Proposition 1A be approved or fail passage?
- Proposition 1A requires the state to establish a reserve fund that will grow to 12.5% of the state’s general fund, and only allows withdrawals for limited circumstances. How could the establishment of this reserve fund affect the policy and fiscal interests of cities?
- Proposition 1A requires new state spending to not exceed the average growth of revenues over a 10-year trend line. Any excess revenues that may come into state coffers that exceed the average of the ten-year trend line are required to be placed in the reserve fund. The measure requires that if the reserve fund exceeds 12.5 % of the state’s general fund, then the excess revenues shall be spent on specified one-time expenditures that include debt repayment and infrastructure projects. How could the establishment of these restrictions on state expenditures during years of excess revenue affect the policy and fiscal interests of cities?
- What is the existing fiscal condition of the state and how will it be affected should Proposition 1A and the rest of the measures placed on the May 19th ballot pass or fail?

Staff Recommendation: Support, for the following reasons:

- 1) The last several decades of local government experience – with losses of local property tax, measures that jeopardized the receipt of local Vehicle License Fees, measures like the “triple-flip” which create uncertainty, various takings of local redevelopment funds, deferral of state mandate payments, borrowing local transportation dollars, constant threats to funds dedicated to local public safety, and other measures – leave no doubt that local government revenues remain highly vulnerable whenever the state runs low on funding. Over the long run, this measure will establish and maintain a healthy state reserve fund and ensure more disciplined state spending when revenues spike.
- 2) A state government with required healthy reserve funds and one that is less prone to “boom and bust” spending cycles will provide the Legislature with resources to address economic downturns without needing to attempt to tamper with local revenues.
- 3) The state’s demonstrated inability to establish and maintain prudent reserves and to make prudent expenditure decisions during “boom” revenue periods has led to chronic state budget crises that have proved harmful to the state’s economy and business

climate. The passage of Proposition 1A will send positive signals to the marketplace and improve California's ability to create and maintain jobs.

- 4) This measure is consistent with elements of policy guidelines for state legislative and budget reforms that were adopted by the League board, including requiring the state to establish "a prudent reserve fund."

Existing League Policy: State Legislative and Budget Reforms. *To stabilize state funding and programs and reverse the trend of the state's reliance on local revenues to solve the state's fiscal crises, the state should implement fiscal and legislative reforms which may include for consideration the following:*

- *A two-year spending plan with the first session focused on expenditures over the period.*
- *Oversight hearings that review programs for savings, duplication or gaps in services.*
- *Limits on the number of bills that legislators may introduce.*
- *A prudent reserve fund.*
- *Official records kept of all Assembly official meetings.*
- *A balanced deficit reduction approach, which could include temporary revenue increases dedicated solely to retiring short-term debt, spending cuts, short-term borrowing and multi-year spending limitations.*
- *Long term restructuring measures, including increased local government property tax shares to create balanced growth and separate budget detail of all state expenditures at local level.*

Prior to the passage of the state budget on February 19, the Governor's Office asked the League to consider supporting ACA x3 1(Niello), now Proposition 1A. The League's Executive Director promised then to bring it to the board for formal position. At the February 19-20 Board meeting, the Board requested to have the League's Revenue and Taxation Policy Committee review the measure at the April 2-3, 2009 Policy Committee meetings and make a recommendation to the Board.

Existing Constitutional Law:

The existing California Constitution (Art 16, Sec. 20) establishes the "*Budget Stabilization Account.*" The Controller is currently required to annually transfer into this account 3% of the estimated amount of General Fund (GF) revenues for the current fiscal year. The total balance allowed in this account in any given fiscal year cannot exceed the greater of \$8 billion or 5% of GF revenues. A total of 50% of each year's contribution (Up to an aggregate amount of \$5 billion) is required to be deposited into the *Deficit Recovery Bond Retirement Sinking Fund Subaccount.* The Governor is authorized to suspend or reduce transfers to this account through executive order. *(This Provision was approved by the voters as part of Proposition 58 on the March, 2004 ballot. An accompanying measure was Proposition 57, also approved by the voters which authorized \$15 billion in deficit recovery bonds.)*

This Initiative (Proposition 1A):

This measure --if approved by the state voters at the Special Election on May 19th, -- does the following:

- 1) Renames the existing Budget Stabilization Account the *Budget Stabilization Fund*, and increases the maximum amount authorized to be deposited in the fund from 5% to 12.5% percent.
- 2) Maintains the existing required 3% of General Fund contribution requirement.
- 3) Commencing on July 1, 2011, removes the ability of the Governor to suspend or reduce required contributions to the Budget Stabilization Fund through executive order unless Legislature adopts a statute transferring money from the Fund to the General

- Fund to satisfy any "gap" that may exist between the total GF revenues available in the prior fiscal year and the "expenditure forecast amount," which is the total expenditure for the prior fiscal year adjusted for population growth and increases in the Consumer Price Index;
- 4) Authorizes withdrawals from the Budget Stabilization Fund to occur with legislative approval to respond to a natural disaster or other extreme emergency declared by the Governor; and authorizes loans for state cash flow purposes to the GF to be repaid within the same fiscal year.
 - 5) Requires – *if Proposition 1B is approved* – 50% of the required annual contribution to the Budget Stabilization Fund to be allocated to a newly created *Supplemental Education Payment Account* that would pay the amounts owed to public education under Proposition 98 for 2007-08 and 2008-09 fiscal years (\$9.3 billion). Once the \$9.3 billion is repaid, then the full 50% contribution will flow into a newly created *Supplemental Budget Stabilization Account* that is limited only for either retiring state debt or investing in infrastructure or other capital outlay purposes.
 - 6) Requires – *if Proposition 1B fails passage* – 50% of the annual contribution to the Budget Stabilization Fund to be allocated to the *Supplemental Budget Stabilization Account* that is limited only for either retiring state debt or investing in infrastructure or other capital outlay purposes. *(These funds will flow indefinitely. There is no ending date or maximum amount (like the \$9.3 billion cap under Proposition 1B for repayment to schools.)*
 - 7) Requires 25 percent of each year's annual contribution to the Budget Stabilization Fund to be allocated to each year's contribution (Up to an aggregate amount of \$5 billion) to be deposited into the existing Deficit Recovery Bond Retirement Sinking Fund Subaccount. *(This requirement is the same as existing law, but only 25% of the total contribution will flow into this account, given that a full 50% (of the total GF contribution) will be dedicated – if Prop. 1B passes – to the repayment of education obligations for a number of years, or – if prop 1B fails – permanently to infrastructure projects or retiring debt.)*
 - 8) Requires the remaining 25% of each year's annual contribution to remain in the Budget Stabilization Fund to begin to accumulate as the "rainy day reserve."
 - 9) Requires that if the Director of Finance determines at any time unfunded obligations to schools exist under Prop. 98 for a fiscal year that exceeds the amount of funds available for education, that he/she shall report this to the Legislature, Governor and Controller. Upon receiving this notification the Controller shall transfer this amount to the General Fund for these purposes. *(There is some confusion with the drafting of this area of the bill and whether it is limited to unanticipated revenues. The League is seeking clarification from DOF.)*
 - 10) Requires the Director of Finance, for the 2010-11 fiscal year and annually thereafter, to calculate the state *revenue forecast amount* (used for establishing revenues available for the state budget) for the preceding 10 fiscal years, and exclude from the calculation revenues derived from any state tax increases that are not in effect for the full 10-year period, and the \$15 billion in previously issued Deficit Recovery Bonds.
 - 11) Requires the Director of Finance, on an annual basis commencing on or before May 29, 2011, to perform a calculation to determine if there are any "unanticipated revenues" for a fiscal year.
 - 12) Requires any "unanticipated revenues" received by the state to be appropriated to fund the following priorities:
 - First priority: unfunded General Fund Prop. 98 obligations to schools.
 - Second priority: transfers to the Budget Stabilization Fund up to the 12.5% cap, but additional Prop 98 payments can be made from that amount.
 - Third priority: any of the following: unfunded Prop. 98 school funding obligations from the prior fiscal year; repayment obligations for amounts owed for property taxes borrowed under Proposition 1A of 2004; repayment

obligations for transportation revenues borrowed under Proposition 42; to repay the 2004 state deficit reduction bonds.

- 13) Requires any additional amount of unanticipated revenues that are not expended pursuant to paragraph 8 (above) to be used for any of the following:
- Transfer additional amounts to the Budget Stabilization Fund;
 - Pay for one-time infrastructure projects;
 - Retire outstanding state bond debt;
 - Return funds to taxpayers through one-time revision to tax rates;
 - Fund unfunded liabilities for vested nonpension benefits for state annuitants.

AB x3 3 (Evans): State Tax Increases: Interaction with Proposition 1A:

State tax increases only require a two-thirds vote of the Legislature. AB x3 3, (Evans), (Ch. 18, 3rd Ex., Statutes of 2009), passed as part of the state budget agreement imposed various taxes and contains “trigger” language that extends the duration of these taxes if the voters approve Proposition 1A:

Sales Tax. Increases the current statewide sales and use tax rate by 1% as of April 1, 2009. The rate increase sunsets on July 1, 2011. Trigger language requires that if voters approve Proposition 1A, then this tax increase will continue until July 1, 2012.

Vehicle License Fee. Increases the rate of the vehicle license fee (VLF) for all vehicles, except for commercial vehicles – with a gross weight of 10,000 pounds or more – by 0.5 percent. While the revenue from the 0.35 percent increase will be deposited into the General Fund, revenue from the 0.15 percent increase will be transferred to a newly created Local Safety and Protection Account, appropriated for specific local public safety programs. The VLF rate increase will become effective for registrations beginning May 19, 2009. The rate increase sunsets on June 30, 2011. Trigger language requires that if voters approve Proposition 1A then the tax increase will continue until July 1, 2013.

Personal Income Tax. Increases the personal income tax rate by *either 0.25 percent or 0.125 percent* to each marginal personal income tax rate, or to the alternative minimum tax rate, (taxpayers pay whichever is higher) for the years 2009 and 2010. The amount of this increase will be determined by the Treasurer and the Director of the Department of Finance, or designees, who are required to meet and confer at a public hearing to be held on or before April 1, 2009. The Treasurer and Director of Finance, pursuant to language contained in AB x3 16 (Evans), will determine whether or not sufficient federal funds have been made available to offset not less than \$10 billion General Fund expenditures. If they *do not* determine that sufficient funds are available, the tax increase will be 0.25 percent. If they *do* determine that sufficient funds have been made available, then the tax increase will be 0.125 percent. Trigger language requires that if voters approve Proposition 1A then the tax increase will continue until January 1, 2013.

Tax Credits. Reduces the current dependent tax credit of \$309 to \$227, and the personal income tax credit of \$99 – given to taxpayers who are over 65, and to taxpayers filing a joint return with their spouse/domestic partner – to \$52, for the years 2009 and 2010. Trigger language requires that if voters approve Proposition 1A, then the tax increase will continue until July 1, 2013.

Governor’s Mid-Year Cut Authority: Interaction with Proposition 1A: The September, 2008, State Budget Agreement, contained a provision that granted the Governor’s Director of Finance the authority to make automatic mid-year budget reductions in the event that total revenues available to the state decline substantially below the revenue estimate upon which the enacted budget was based. That provision (Sec. 13312 Govt. Code) has never taken effect

because it was contingent upon voter approval of Constitutional provisions that have not occurred. SB x3 8 (Ducheny) which was part of the February 2009 budget agreement (Ch. 4, 3rd Ex, Statutes of 2009) modifies this statute and makes its enactment contingent upon the enactment of Proposition 1A.

Thus, if Proposition 1A is approved, the Director of Finance is authorized to:

- Make up to a 7% reduction in state operations or capital outlay funded through the general fund. (Numerous items are exempted from this including allocations for local assistance and Proposition 42 sales tax on gas for transportation).
- Suspend scheduled cost of living increases for up to 120 days, in conjunction with the Governor's declaration of the need for a Special Session of the Legislature to address a state fiscal emergency because state revenues have declined substantially below the revenue estimate upon which the enacted budget was based.
- According to the Department of Finance, this authority will allow DOF to trim approximately \$1.3 billion from the projected \$8 billion 2009-10 deficit.

Other Measures on the May 19th Ballot:

Proposition 1B: Education Funding. Payment Plan. (ACA x3 2 (Bass). This measure is contingent upon provisions contained within Proposition 1A (spending cap). If both Proposition 1A and this measure are approved, schools and community colleges will receive supplemental education payments totaling \$9.3 billion in funding obligations to schools commencing in FY 2011-12. These payments are in lieu of designated maintenance factor payments to schools under Prop 98 for FY 2007-08 and FY 2008-09.

Proposition 1C: Lottery Modernization Act. (AB x3 12 (Evans). Makes several adjustments to audit and other provisions relating to the State Lottery. These changes are consolidated into the previous lottery modernization provisions that were approved as part of the 2008-09 State Budget. The Administration is anticipating "securitizing" the expected additional proceeds gained through modernizing and using the expected \$5 billion to assist in balancing the budget in the 2009-10 fiscal year.

Proposition 1D: Children's Services Funding (AB x3 17 (Evans). Redirects between \$275 to \$340 million in one-time reserve funds, and authorizes \$268 million to be diverted annually for five years from Proposition 10 (tobacco tax for children's health care) for programs with similar objectives funded under the General Fund.

Proposition 1E: Mental Health Funding Budget (SB x3 10 (Ducheny). Redirects \$226.7 million in FY 2009-10, and up to \$234 million in FY 2010-11, from Proposition 63 (tax on millionaires for mental health services) for programs with similar objectives funded under the General Fund.

Proposition 1F: Elected Official's Salaries. Prevents Pay Increases During Budget Deficit Years (SCA 8 (Maldonado). This bill prohibits the California Citizens Compensation Commission from increasing the salary of any state officer that would take effect in December if there is an operating deficit of more than one percent as determined by the Director of Finance on June 1st of the preceding fiscal year.

Support/Opposition:

Support (as of 3-22-09): The following groups or individuals are listed by the support coalition as supporting either all or specific propositions in the package: Public Safety: California Fire Chiefs Association (All); California Police Chiefs Association (All); California State Sheriffs' Association (All); California Peace Officers' Association (All); Chief Probation Officers of California (All); California Narcotics Officers' Association (All); California Coalition of Law

Enforcement Associations (All); California Probation, Parole and Correctional Association (All); California Asian Peace Officers Association (1A, 1B, 1C, 1F); Los Angeles County Professional Peace Officers Association (1A, 1B, 1C, 1F); Sheriff Lee Baca, County of Los Angeles (1A, 1B, 1C); Sheriff William Kolender, County of San Diego (All); Michael Ramos, San Bernardino County District Attorney (All). Taxpayers: California Taxpayers' Association (1A), National Tax Limitation Committee (1F). Seniors: California Senior Advocates League (1A). Education: California Teachers Association (1B); California State PTA (1B, 1C); California Business for Education Excellence (1A, 1C); Small School Districts' Association (1A, 1B, 1C, 1F); The California Latino Child Development Association (1D); Dr. Glen W. Thomas, California Secretary of Education (1A, 1C); Jordan Brandman, Trustee, Anaheim Union High School District (1A, 1B, 1C, 1E, 1F); Kevin Gordon, President, School Innovations & Advocacy (All). Statewide Business Groups: California Chamber of Commerce (All); California Retailers Association (All); California Black Chamber of Commerce (All); Silicon Valley Leadership Group (All); Bay Area Council (All); Central California Hispanic Chamber of Commerce (All); California Business Roundtable (1A, 1C); Small Business Action Committee (1A, 1B, 1D, 1E, 1F). Labor: California Alliance for Jobs (All), California State Council of Laborers (All). Health: Association of Regional Center Agencies (1D). Elected Officials: Governor Arnold Schwarzenegger (All); Darrell Steinberg, Senate President Pro Tempore (All); Karen Bass, Speaker of the California State Assembly (All); Michael Villines, Assembly Republican Leader (All); Dave Cogdill, California State Senator (All); Bill Jones, Former Secretary of State (1A); Steve Westly, Former State Controller (All); Abel Maldonado, California State Senator (1F); Tom Campbell, Former Director, Dept. of Finance, Former U.S. Congressman, Former California State Senator (1A); Fred Keeley, Treasurer, County of Santa Cruz and Former Speaker Pro Tem, California State Assembly (All); Charlene Zettel, Former California State Assembly member (1A, 1C); Chet Reilly, Kingsbury City Council (All).

Opposition (as of 3-22-09): Taxpayer: Howard Jarvis Taxpayers Association. Health: Health Access California, United Nurses Association of California /Union of Health Care Professionals. Senior: Older Women's League of California, Congress of California Seniors. Consumer: Consumer Federation of California. Education: California Faculty Association.

Fiscal Impact:

State:

1. The Legislative Analyst recently projected an \$8 billion deficit for the 2009-10 budget year. In the short term the approval of this measure would mean that the "trigger" included in AB x3 3 (Evans) would be enacted and the tax increases agreed to as part of the February 2009 budget agreement would be extended by up to two years, thereby providing and estimated \$16 billion in additional revenue to offset anticipated future state deficits. The Governor would also secure some mid-year budget adjustment authority. If this measure is approved in conjunction with the approval of Proposition 1B, schools are guaranteed to receive \$9.3 billion, approximately \$1.5 billion per year commencing in commencing in FY 2011-12, thereafter the funds will flow to either retiring state debt or investing in infrastructure or other capital outlay purposes. However, if Proposition 1B is not approved, these funds will be dedicated to either retiring state debt or investing in infrastructure or other capital outlay purposes.
2. The approval of this measure, however, would reduce by half (at least for the next six or seven years) the amount of revenue allocated to retire the existing Deficit Recovery Bond Retirement Sinking Fund Subaccount that is dedicated to paying off the 2004 \$15 billion Deficit Recovery Bond. *(This is because Prop. 1A will divert 50% of the existing (3% of GF) contribution to either repaying schools, or if Prop 1B fails, funding infrastructure and debt retirement. This observation, however, assumes that in the absence of Prop. 1A, future Governors will not continue through executive order to suspend or reduce contributions into the existing Budget Stabilization Account.)*

3. Even if Proposition 1A is approved, given that most of its provisions take effect in 2011, and assuming the state experiences modest rates of economic growth – absent huge spikes in “unanticipated revenues” – it could be 8-10 years, or longer, before the state may accumulate a 12.5% of GF “Rainy Day Fund.”

Local:

1. In the short term, the two most direct potential benefits associated with the approval of Proposition 1A for city government, is that (1) this is a critical element of the state budget package – one that does not attempt to take local revenue. The defeat of this measure will likely reopen and expand the debate over how to close the state’s deficit; and (2) the 0.15% VLF increase for local public safety programs included in AB x3 3 (Evans), per the trigger contained in that bill, will be extended for two additional years.
2. Over the long term, Proposition 1A – while it has its flaws – charts a path toward a future in which the state will maintain a healthy reserve fund and spend its “unanticipated revenue” on debt repayment, infrastructure projects and other one-time measures. This measure also includes a priority for the repayment of any outstanding Prop. 1A (property tax) loans and Prop. 42 (transportation) loans, but does not in any way amend those constitutional amendments or appear to affect the obligations imposed by those measures.

Comments:

- 1) Some political context is needed to understand the various triggers attached to the voters decision on Proposition 1A. The Governor – and other groups that support the state’s adoption of more stringent reserve funds and impose discipline on state spending during periods of excess state revenue – understood that powerful groups that desire increased state spending for their interests and programs would likely mobilize to oppose this measure. Thus in the “art of the deal” various provisions have been attached to the success of this measure to discourage major political opposition at the ballot box:
 - Continuation of state tax increases by one or two years.
 - \$9.3 billion in repayment funds for education.
 - The governor’s desired mid-year cut authority.

While the above triggers may prove successful in avoiding some opposition, their inclusion has attracted others. Also, some organizations simply do not like the spending limitations.

- 2) While it may be argued that Proposition 1A is a vote on tax increases, nothing in the measure directly affects taxation. Even if Proposition 1A fails, there is nothing to stop the Legislature from agreeing (with a two-thirds vote) in the future to extend the taxes increased by AB x3 3 (Evans), or to enact other tax increases.
- 3) State infrastructure spending will benefit from this measure, which calls for 1.5 percent of the General Fund to be dedicated to either infrastructure or debt relief after the education payments under Proposition 1B are completed.