

**SACRAMENTO UPDATE**  
**FEBRUARY 2009 – BUDGET**

On February 19, 2009, the Legislature passed the 2009-10 Budget Act and changes to the current year budget to close the \$41 billion deficit facing the State of California. The combined actions include a mix of tax increases, budget cuts and loans. Specifically, \$15.1 billion in cuts, \$12.9 billion in tax increases, \$11.4 billion in borrowing. If the state receives \$10 billion in federal stimulus money, cuts drop by \$1.2 billion, borrowing by \$5.5 billion and tax increases by \$1.8 billion.

The budget deal would place five measures on a special election ballot on May 19, 2009. The five measures concern: borrowing from the lottery, changing Proposition 98, approving the spending cap, and taking funds from Proposition 10 (tobacco tax for early childhood programs), and Proposition 63 (tax on millionaires for mental-health programs). There will be two additional constitutional amendments on the June 2010 ballot, one to establish an open primary system and second banning legislative pay increases during deficit years.

**Summary of all Solutions**  
**(Numbers are estimates only)**

<b>\$ Millions</b>	<b>Two Year Total</b>
Expenditure Reductions	<b>15.1 B</b>
Revenues	<b>12.9 B</b>
Lottery	<b>5.0 B</b>
RAWS	<b>5.9 B</b>
Other Borrowing	<b>.4 B</b>
<b>Subtotal</b>	<b>39.3 B</b>
Line Item Vetoes - TBD	<b>.6 B</b>
Additional Federal Stimulus	<b>TBD</b>

**TAX INCREASES**

	Effective Date	Estimated Revenue Increase in 2008-09 and 2009-10
1-cent Sales Tax Increase	April 1, 2009	\$5.8 B
Income Tax Bracket Increase - .25%	Tax Year 2009	\$3.6 B
Vehicle License Fee Increase – from 0.65% to 1.15% of value	May 19, 2009	\$2.1 B
Reduction of dependent care credit from \$309 to \$98	Tax Year 2010	\$1.4 B
<b>Approximate Total</b>		<b>\$12.9 B</b>

The tax cuts will be temporary, depending on the passage of the measures before the voters. If the spending cap is approved by the voters, the tax increases would last longer – up to an additional three years.

The .25% increase to income tax brackets was added in lieu of the 12-cent gas tax in the final hours of budget negotiation. It also replaces the original proposal of a 5% Personal Income Tax (PIT) surcharge. If we meet

the Federal trigger, the income tax bracket rate increase will be reduced to .125%. While the .25% bracket increase generates \$400 million more in personal income tax than the original 5% PIT surcharge, it broadens the increase so that more taxpayers will pay.

## TAX INCENTIVES

	Estimated Revenue Loss in 2008-09 and 2009-10
Elective Single Sales Factor	\$600 M
Small Business \$3,000 Per Employee Credit for New Hires	\$400 M
Film Production Credit	\$100 M

## MAJOR PROPOSALS

We anticipate that Schwarzenegger will line-item veto approximately \$600 million in expenditures. This was apparently discussed as part of the final-hour budget negotiations.

- Local Government
  - The budget does not borrow from local governments via the Proposition 1A or 42 formulas.
  - The budget proposes the creation of a new ongoing funding source for the Citizens Option for Public Safety/Juvenile Justice Crime Prevention Act (COPS/JJ) program, Juvenile Probation grants, and the Booking Fees program. Funding for the Account will come from the increase in vehicle license fees. Currently, the VLF is 0.65% of the car's value; the budget increases the rate to 1.15% of the value and dedicates the 0.15% to the COPS/JJ programs. (However, there is a partial reduction in the current year). The estimated annual revenue generated from the 0.15% portion of the VLF is \$500 million.
  - The budget does not redirect any redevelopment funds, as proposed by the Governor.
- Transportation
  - Cuts funds for public transit operations, but does not suspend Prop. 42.
  - The budget cuts \$150 million in 2008-09 and \$306 million in 2009-10 from local transit grants. Funds made available by this proposal are shifted to transportation programs previously funded by the General Fund including Home-to-School Transportation.
  - Additionally, the budget proposes trailer bill language that would redirect the \$100.8 million in annual tribal gaming revenues from funding transportation projects to the General Fund in 2008-09 and 2009-10, contingent on federal stimulus funds to back-fill the lost revenue.
- Prop. 98 Education
  - Prop. 98 NOT suspended, but funded at minimum guarantee level.
  - Major reductions in current and budget years totaling \$8.6 billion, but actual level of programmatic cuts is much less with deferrals, swaps, and other changes making up the remainder.
  - Current-year adjustments:
    - Programmatic cuts: \$2.65 billion.
    - K-12 cuts split 50-50 between revenue limits and categorical programs (categorical cuts are across-the-board).
    - No cuts to four categoricals: Special Ed., Economic Impact Aid, K-3 Class Size Reduction, and School Lunches.
    - Deferral (current-year to budget year): \$2.8 billion.
    - Counting current-year appropriation toward Prop. 98 "settle-up" \$1.1 billion.

- Using Public Transit Account (rather than General Fund) for Home-to-School Transportation: \$618 million.
  - Budget-year adjustments:
    - Programmatic funding: about the same as current year (no COLA).
    - Cuts again split 50-50 between revenue limits and categoricals.
    - Same categoricals protected as current year (Special Ed., EIA, CSR, lunch).
  - Long-term stability for school funding:
    - Governor proposed to not recognize \$9.3 billion owed to schools as Prop. 98 “maintenance factor” which would have been a permanent reduction, compromise package restores the \$9.3 billion over a period of years.
- Health and Human Services
    - CalWORKs and SSI/SSP COLAs suspended.
    - Department of Developmental Services: 10% cut in rates, if other options not achieved (3% rate cut in December package).
    - Prop. 10: ½ of state and local commission funds diverted to pay for state children’s health programs for 5 years.
    - Prop. 63: Funds diverted to pay for EPSDT for 2 years.
    - Other smaller cuts to county administration, technology.
    - “Triggered” cuts (if federal funds don’t come):
      - CalWORKs: 4% grant cut.
      - Medi-Cal: Eliminate certain optional benefits (primarily dental).
      - SSI/SSP: Monthly grant reductions of \$20 to \$35.
      - IHSS: Cap on state participation in wages of \$9.50, plus benefits, and share-of-cost for prospective clients.
  - Higher Education
    - Adopts Governor’s UC and CSU proposals:
      - No funding for “compact.”
      - 10% across-the-board cut.
      - Reduced costs for retirement contributions.
    - Not cut: Governor’s proposed cuts to CalGrants (including competitive grants and “de-linking” with fee increases).
    - “Triggered” cuts (if federal funds don’t come): Additional cut of \$75 to \$150 million each to UC and CSU (offset by increase in CalGrants, if segments increase student fees).
  - Horse Racing
    - The budget includes a General Fund appropriation of \$32 million for the state’s fairs, and it relieves the horse racing industry of their current obligation to pay that amount. The allocation is not linked to tribal gaming revenue.
  - State Employees
    - Assumes savings associated with furloughs, eliminates two state holidays, and makes changes to overtime rules.
  - Judicial
    - Unallocated reductions to the courts, including additional “triggered” cuts

## **Borrowing:**

- \$11.4 billion (reduced to \$5.9 billion, if federal funds “trigger” pulled):
  - \$5 billion from lottery securitization (requires voter approval in special election in May or June).
  - \$5.9 billion for Revenue Anticipation Warrant (RAW) sale.
    - Replaced with federal funds, if “trigger” pulled.
  - \$400 million in loans and transfers from various special funds.

## **Spending Cap:**

- Limits spending to rolling 10-year trend in revenues, amounts above the 10-year trend would go into the “rainy day fund.”
  - Allows adjustment of the spending limit to accommodate new tax increases.
  - Money can be removed from the “rainy day fund” when revenues fell below a “current-service” level budget.
  - Reduces the annual deposit from 3% to 1.5% (other 1.5 dedicated to education).
    - 1.5% annual deposit ceases when fund is equal to 12.5% of revenues.
  - Revenues above the trend line after the “rainy day fund” is full can be used for various one-time spending purposes, which can help balance the annual budget.
  - Addresses the Prop. 98 maintenance factor issue, ensuring that base funding to the schools is restored by \$9.3 billion over time (separate ballot measure).

## **Economic Stimulus Provisions:**

- Unlimited Public Private Partnerships for transportation through 2017 and up to 4,500 beds in corrections reentry facilities.
- Use of “design-build” in 10 state transportation projects, 5 local transportation projects, 10 Redevelopment Projects, and 5 other state office buildings.
- Clarified the schedule options that can be voted on by employees.
- CEQA exemptions for 8 specific projects.
- Diesel agricultural equipment eligible for Carl Moyer Program.
- CEQA exemption for the sale of surplus state property.
- Single Sales Factor Apportionment
  - Allows most multi-state businesses to apportion income to California using only their percentage of sales in California. Effective in tax year 2011.
- Film/TV Production Credit
  - Provides a credit of 20 percent or up to 25 percent of the qualified production cost of qualified motion pictures or TV series that are produced in California.
  - Producers must apply to the California Film Commission for a credit allocation. Allocations begin 2009-10, and first credits could be claimed for 2011. \$500 million in allocations would be available over five years.
- Small Business Hiring Credit

- Provides a credit of \$3,000 per full-time equivalent employee added by small businesses (20 employees or less). The credit will be available for the 2009 and 2010 tax years.