RULES COMMITTEE: 2-18-04
ITEM: C1a

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: RULES COMMITTEE

FROM: Betsy Shotwell

SUBJECT: SEE BELOW

DATE: February 12, 2004

Approved [signature] Date 2/13/04

SUBJECT: APPROVE CITY POSITIONS ON MARCH 2004 STATE BALLOT PROPOSITIONS

RECOMMENDATION

Approve the recommended City positions for each of the statewide ballot propositions set for the March 2, 2004 Primary Election. Individual ballot proposition analyses are attached (Attachment A) for your consideration. Portions of the Secretary of State's "Official Voter Information Guide", which includes the Attorney General's title and summary of each proposition, the Legislative Analyst's analyses, and arguments pro and con is also attached, (Attachment B). A one-week turnaround to Council is requested.

Proposition		Recommended Position
55	Kindergarten-University Public Education Facilities Bond Acts of 2004.	Support
56	State Budget, Related Taxes, and Reserve. Voting Requirements. Penalties	Support
57	The Economic Recovery Bond Act	Support
58	The California Balanced Budget Act	Support

PUBLIC OUTREACH

Not Applicable

COORDINATION

The analyses of the measures was coordinated with the City Attorney's Office, Budget, Finance, Parks Recreation and Neighborhood Services, and the City's Legislative Representative in Sacramento.

Betsy Shotwell
BETSY SHOTWELL
Director, Intergovernmental Relations

Attachments

March 20004 State Ballot

PROPOSITION 55: KINDERGARTEN-UNIVERSITY PUBLIC EDUCATION FACILITIES BOND ACT OF 2004

Recommended City Position: Support

Synopsis:

AB 16 (Hertzberg, Chapter 33, 2002) authorized two statewide general obligation bond elections, one in 2002, and one in 2004. In the November 2002 election, the Kindergarten-University Public Education Facilities Bond Act of 2002, Proposition 47, was passed by the voters allocating $13.05 billion for public school facility maintenance and improvements. The City Council of San Jose supported Proposition 47 in 2002. If Proposition 55 is passed, the voters would authorize another $12.3 billion in bonds to fund similar improvements for public schools. $10 billion of these funds would go to public schools, Kindergarten through 12th grade for new school construction, modernization of older schools, expansion of critically over-crowded schools. $2.3 billion would be allocated to the UC, CSU, and CCC systems. I revised because the Proposition only deals with the bond issue. The implementation issues are dealt with in AB 16.AB 16 requires that the state modernization grants be matched by the school districts on a 60% (state)-to-40% (local) basis for projects filed after March 12, 2002.

The cost of these bonds would depend on their interest rates and the time period over which they are repaid. If the $12.3 billion in bonds authorized by this proposition is sold at an interest rate of 5.25 percent (the current rate for this type of bond) and repaid over 30 years, the cost over the period would be about $24.7 billion to pay off both the principal ($12.3 billion) and interest ($12.4 billion). The average payment for principal and interest would be about $823 million per year.

Analysis:

Advocates of Proposition 55, including the California State PTA and the California Teacher's Association, consider the additional $12.3 billion to be essential for public schools. By early next year, virtually all of the funds from Proposition 47 will already be committed. Proposition 47 will provide for only half of the 46,000 classrooms needed to relieve overcrowding and accommodate new enrollments. In fact, nearly 1000 school sites are classified as "critically overcrowded" and by the end of this decade enrollment in the California public school system is expected to swell by approximately 1 million students. According to the National Education Association, only two states, Arizona and Utah, have more students per classroom than California. In addition to the necessary improvements and expansion, supporters estimate that 250,000 new jobs will be created if the second half of the Bond Act is approved. They emphasize that this is the only way to fund improvements in the public school system without raising local taxes.

Staff Recommendation:

The City of San Jose supported Proposition 47 on the November 2002 State ballot because the City has many programs and capital project partnerships with both the K-12 schools and higher education in the San Jose area. For these reasons, staff recommends support for Proposition 55.

PROPOSITION 56: STATE BUDGET, RELATED TAXES, AND RESERVE. VOTING REQUIREMENTS. PENALTIES

Recommended City Position: Support

Synopsis:

This initiative measure known as the "Budget Accountability Act", proposes to amend the State's Constitution and statutes to change the state budget process. The main provisions of the proposition are as follows:

- **Votes on State Budget-Related Taxes and Spending**: Permits Legislature to enact with 55 percent vote rather than the two-thirds vote currently required.
- **Reserve Requirements**: Requires 25 percent of "excess state revenue" (up to 5 percent of the prior year's General fund spending) to be set aside. Reserve funds could be spent only in certain circumstances.
- **Consequences of a Late Budget**: Requires that Legislature and Governor lose salary and expenses each day the budget is late. Requires the Legislature stay in session until budget is passed.
- **Other Provisions**: Requires the budget summary in State ballot pamphlet and directions to an Internet Web site providing budget-related vote information.
- **Prohibits a legislator from:** punishing or threatening to punish another legislator for budget-related vote.

Analysis:

Proposition 56, is sponsored by the Service Employees International Union, California Teachers Association, AFL-CIO, and the League of Women Voters and other groups to lower the vote threshold for the approval of the State budget from a two-thirds vote to 55% of each house of the Legislature. In addition, the initiative's sponsors want to hold the Governor and the Legislature more accountable to produce a more timely State budget by prohibiting payment of salary or per diem expenses to the legislators or to the Governor for each day the budget is late. The measure is opposed by the California Chamber of Commerce, the California Taxpayers Association, and the Silicon Valley Manufacturers Group. Concerns listed include that the proposition would lower the vote requirement for budget-related tax/appropriation bills from the current 2/3 legislative vote to 55%. The League of California Cities (LOCC) Board adopted no position on Proposition 56 at their November meeting. "If conditions change leading the policy committee or the executive committee to recommend a different League position, the issue will come back to the board at its next meeting."

The State budget bill provides the annual funding for most State government programs. Currently, before the budget bill is sent to the Governor for approval, it must be passed by a two-thirds vote (67 percent) of each house of the Legislature. The State Constitution requires legislative passage of the budget bill by June 15 of each year. The Constitution does not, however provide a deadline for the Legislature and the Governor to come to a final agreement on

the budget bill. California is currently one of only three states t
vote on adoption of a budget with Arkansas and Rhode Island the other two states.

According the Legislative Analysts' Office, (LAO) Proposition 56 reduces from two-thirds to 55 percent the number of votes required to pass the budget bill and other bills- including tax increase measures – related to the budget bill.

The measure also establishes minimum requirements for putting money into and taking money out of the state reserve fund. The LAO indicates that under the measure, "funds would be added to the reserve in any year in which State revenues exceeded what was needed for "current service levels." "Current service levels" is defined to mean the level of service as of June 30 of the prior fiscal year to meet constitutional, statutory and contractual obligations of the State, adjusted each year for population changes and inflation.

Specifically, the measure requires the Legislature to put in the reserve at least 25 percent of any excess revenues, until the reserve reaches 5 percent of the prior-year's spending. The measure does not restrict the use of the remaining excess revenues. Reserve funds could only be spent in cases of an emergency or in years in which the amount required to fund current service levels exceeded available revenues.

Proposition 56 prohibits the Legislature and the Governor from collecting their salaries and expenses when the budget is late. The amount of unpaid salaries and expenses could not be paid later.

According to the LAO, by reducing the number of votes needed to pass budget-related bills, Proposition 56 would make it easier for the Legislature to pass the budget, or budget related trailer bills. Note that the California Legislature and the Governor have rarely met their constitutional deadline of June 15 under the current 2/3 vote requirement.

Staff Recommendation:

By repeatedly not meeting the budgetary deadlines, the State makes it increasingly difficult for local governments to determine their own budgets each year. Repeated delays in the adoption of a State budget over the past few years have created fiscal uncertainty for local governments, schools, and vendors. A delayed State budget jeopardizes sound fiscal planning at the city level as most cities are on a July-June fiscal year. Cities frequently must go back and realign their adopted fiscal year budget once the State budget is passed. For t
support for Proposition 56.

PROPOSITION 57: THE ECONOMIC RECOVERY BOND ACT

Recommended City Position: Support

Synopsis:

Proposition 57 was placed on the March ballot with the passage of AB 9(5x)(Oropeza, Chapter 2, Statutes of 2003 special session). Sponsored by Governor Schwarzenegger, this measure authorizes the State Treasurer, subject to voter approval at the March 2nd election, to sell up to $15 billion of economic recovery bonds to finance the 2004-05 year-end general fund deficit and the cost of other general fund obligations existing prior to June 30, 2004. In order for Proposition 57 to become effective, Proposition 58 must also be approved by the voters.

Analysis:

Context of Proposition 57

In August 2003, the Legislature and former Governor Davis approved a total of $12.6 billion in borrowing, ($10.7 billion deficit bond and $1.9 billion pension bond), in response to the $38.2 billion general fund shortfall that existed with FY '03-'04 State budget. According to the Legislative Analyst Office (LAO), "one of the key actions taken to deal with the projected current-year (2003-4) budget shortfall was the authorization of a $10.7 billion deficit-financing bond. The purpose of this bond was to "wipe the slate clean" and eliminate the cumulative budget deficit that would have existed at the end of 2002-03. This would allow the State to avoid the more severe budget actions that would have been necessary to eliminate the deficit all at once." The repayment of the currently authorized bond "would result in annual general fund costs equivalent to one-half cent of the California's sales tax – or about $2.4 billion in 2004-05 and increasingly moderately each year thereafter – until the bond is paid off (in about five years)."

This $10.7 billion deficit bond is currently being challenged in court and has not yet been issued. The LAO further adds, "in the meantime, the carryover 2002-03 deficit is being financed through short-term borrowing, which is due to be repaid in June 2004." If Proposition 57 is approved by the voters, the bonds authorized by Proposition 57 would be used in place of the $10.7 billion deficit-financing bond authorized last year by the Legislature.

For FY '04-'05, the State is facing another large budget shortfall which the LAO estimates will be in the general range of a $15 billion structural deficit. The LAO writes that "this estimate assumes that the currently authorized $10.7 billion deficit-financing bond is sold and that the carryover 2002-03 deficit is thereby taken off the books. Absent the bond proceeds from this sale, the budget shortfall estimate for 2004-05 would be much larger.'

Fiscal Impact of Proposition 57

The repayment of the bond according to the LAO "would result in annual general fund costs equivalent to one-quarter cent of local Bradley-Burns sales tax revenues, ($1.25 billion statewide), compared to costs equivalent to one-half cent of local sales tax revenues, ($2.5 billion), for the currently authorized $10.7 billion bond. In addition, certain funds transferred to the State's Budget Stabilization Account (created in Proposition 58 on this ballot, if approved) could be used to accelerate the repayment of the bond. The measure includes a backup guarantee that if the sales tax revenues dedicated to the bond are insufficient to pay bond principal and interest in any year, the general fund will make up the difference."

The fiscal effects of the bond proposed in Proposition 57 according to the LAO, would result in near-term budgetary savings compared to the $10.7 billion bond authorized by the Legislature, but added annual costs over the longer term. Specifically, "the proceeds from the proposed bond would be $4 billion more than proceeds from the currently authorized bond. This would provide the State with up to $4 billion in additional one-time funds to address its budget shortfall. The State would also realize near-term savings related to debt service on the bond. This is because the payments would be based on one-quarter cent of annual sales taxes instead of one-half cent. As a result, annual general fund costs would be one-half of the currently authorized bond for the next few years."

With regards to longer-term costs to the State, "the near-term savings would be offset by higher costs in the longer term. This is because the proposed bond would be larger ($15 billion versus $10.7 billion) and it would take longer to repay." The bond proposed in Proposition 57 would likely take between 9 and 14 years to pay back, compared to a 5-year period for the currently authorized bond.

The earlier approved deficit reduction bond of $10.7 billion identified as a dedicated revenue source to retire the bond the transfer of one-half cent local Bradley-Burns sales tax from local governments to the State. In exchange, the State committed to transfer a like amount of existing schools' ERAF property tax to local governments. The State pledged to backfill schools with available State funding. This transaction known as the "triple-flip" pledged the transfer of $2.5 billion local sales tax for a five-year repayment of the bond. The proposed authorization in Proposition 57 for up to $15 billion in bonds utilizes a triple-flip, except the diversion of sales tax revenues from local governments to the State is reduced to ¼ cent of California sales tax revenues. According to the LAO, "as a result of these diversions, there is no net impact on local governments or school districts. The full cost of the bond's repayment is borne by the State's general fund."

Summary:

Since 2001 the State has experienced chronic shortfalls between revenues and expenditures when the economic downturns caused revenues to decline sharply. "To deal with these shortfalls," concludes the LAO, "policy makers have reduced program expenditures, raised revenues, and taken a variety of other measures. They have also engaged in various forms of borrowing from special funds, local governments, and private credit markets."

To that end the State has "borrowed" $1.3 billion in vehicle license fee backfill from cities and counties in FY 2003-04 and shifted $135 million from redevelopment agencies to schools in the form of an ERAF transfer. In his recently proposed FY 2004-05 State budget, the Governor proposes a permanent ERAF shift of $1.3 billion from cities, counties, special districts and redevelopment agencies. This ERAF shift would be in addition to the already ongoing ERAF shift of $5.2 billion (and growing based on increase in assessed value) from cities and counties. In addition, redevelopment agencies would be hit with a permanent ERAF shift of $135 million statewide if the Governor's proposed budget is passed as proposed.

Some opponents of the measure suggest that the only way to solve the State's budget problems is to increase taxes while other opponents support greater cuts in expenditures to balance the State's budget shortfall. However, if Proposition 57 is not approved and the Governor continues to oppose the imposition of new taxes, it will become necessary to approve additional cuts in State programs and services. Additionally, failure to approve Proposition 57 could require the State to consider the issuance of the earlier approved $10.7 billion bond to refinance the State's existing debt at a potentially higher annual cost to taxpayers as determined by the terms for repayment. . This assumes that the State would prevail in the court action challenging the issuance of those bonds. If the $10.7 billion bond were successfully challenged in the courts, the State would still be required to refinance the $14 billion in earlier incurred short-term debt whose payment becomes due in June, 2004.

According to the Department of Finance the proposed Proposition 57, authorizing up to $15 billion economic recovery bond, would be used to refinance the $14 billion current debt, but would not address the LAO's and Department of Finance's estimated $15 billion general fund structural deficit.

If Proposition 57 fails and the legal challenge prevents the issuance of the $10.7 billion deficit bond, it is estimated that the State's projected deficit for the combination of FY '03-'04 and FY '05-'06 would be $30 billion. In actions proposed by the Governor and pending before the Legislature to balance the current 2003-04 budget and the proposed FY '04-'05 State budget, the State projected deficit would require the Governor and Legislature to find alternative funding sources to balance the State budget. The projected magnitude could potentially place local governments revenue sources at further risk.

Organizations supporting Proposition 57 include: the California Chamber of Commerce, Silicon Valley Manufacturing Group, California Teachers Association, and the California State Firefighters Association. Senator Tom McClintock opposes the measure. The League of California Cities (LOCC) has as of February 6/7, taken a position in support of both Propositions 57 and 58.

Staff Recommendation:

Staff recommends support for Proposition 57. In addition, staff recommends that the City strongly urge Governor and the Legislature to take actions necessary to provide long-term fiscal reform while not balancing the State budget on the backs of local government.

PROPOSITION 58: THE CALIFORNIA BALANCED BUDGET ACT

Recommended City position: Support

Synopsis:

Sponsored by Governor Schwarzenegger and placed on the ballot with the passage of ACA 5 (5x Oropeza, Chapter 1, 2003, 5x session) Proposition 58 amends the Constitution, making changes related to:

1. The enactment and maintenance of a balanced State budget;
2. The establishment of specific reserve requirements, and;
3. A restriction on certain types of future deficit-related borrowing.

The measure only takes effect if Proposition 57 (the deficit bond measure) on this ballot is also approved by the voters.

Analysis:

Balanced Budget Requirements

Existing law provides for a State appropriations limit that caps appropriation of tax proceeds with certain exceptions. The existing limit requires the State to maintain a "prudent reserve," but does not establish any specific criterion for the reserve or require any specific deposits into it. There is no explicit existing requirement that the Legislature pass or the Governor sign a balanced State budget. The only existing constitutional requirement is that the Governor must propose a balanced budget by January 10 each year.

According to the Legislative Analyst's Office, (LAO), Proposition 58 would "require that the State adopt a balanced budget and provides for mid-year adjustments in the event that the budget bill fall out of balance. In addition to the existing requirement that that Governor propose a balanced budget, this measure requires that the State enact a budget that is balanced. Specifically, estimated revenues would have to meet or exceed estimated expenditures in each year."

With Proposition 58, "if the Governor determines that the State is facing substantial revenue shortfall or spending deficiencies, the Governor may declare a fiscal emergency. He or she would then be required to propose legislation to address the problem, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the budget problem within 45 days, it would be prohibited from (1) acting on any other bills, or (2), adjourning in joint recess until such legislation is passed."

Special Reserve

Proposition 58 also requires that a special reserve – called the Budget Stabilization Account (BSA) – be established in the State's general fund. Specifically, a portion of estimated annual general fund revenues would be transferred by the State Controller into the account no later than September 30 of each fiscal year according to the following schedule: 1 percent (about $850 million) in 2006-07, 2 percent (about $1.8 billion) 2007-08, and 3 percent (about $2.9 billion) in 2008-09 and thereafter. These transfers would continue until the balance in the account reaches $8 billion or 5 percent of general fund revenues, whichever is greater. The annual transfers could be suspended or reduced for a fiscal year by an executive order issues by the Governor no later than June 1 of the preceding fiscal year.

It is important to note that, as outlined in the LAO's analysis of Proposition 58, each year "50 percent of the annual transfers to the BSA would be allocated to a subaccount that is dedicated to repayment of the deficit-recovery bond authorized by Proposition 57. These transfers would be made until they reach a cumulative total of $5 billion" and "funds from this subaccount would be automatically spent for debt service on that bond. The remaining funds in the BSA would be available for transfer to the State's general fund."

Proposition 56 on the March 2nd ballot also includes balanced budget requirements which differ from those described above. If both Propositions 56 and 58 passed, litigation most likely would occur and the courts would be called upon to reconcile the differing provisions.

Deficit Borrowing

Proposition 58 amends the State Constitution in order to address the deficit bond measure authorized by Proposition 57. With regards to future deficit borrowing, the LAO writes that "subsequent to the issuance of the bonds authorized in Proposition 57, this proposal would prohibit most future borrowing to cover budget deficits. This restriction applies to general obligation bonds, revenue bonds, and certain other forms of long-term borrowing. The restriction does not apply to certain other types of borrowing, such as (1) short-term borrowing to cover cash shortfalls in the general fund (including revenue anticipation notes or revenue anticipation warrants currently used by the State), or (2) borrowing between State funds."

Organizations such as the California Chamber of Commerce, Silicon Valley Manufacturing Group, California Teachers Association, and the California State Firefighters Association support Proposition 58 and the Association of Concerned Taxpayers, the San Diego Tax Fighters and the Santa Barbara County Taxpayers Association oppose the measure. The League of California Cities (LOCC) has as of February 6/7, taken a position in support of both Propositions 57 and 58.

Staff recommendation:

Proposition 58 could have a variety of effects on the State's fiscal condition with its requirements for a balanced State budget each year and the restrictions proposed on borrowing. In addition, according to the LAO, "the $8 billion reserve target could be used to smooth State spending over the course of an economic cycle. The proposition could have a variety of other impacts on State finances. For example, to the extent that the measure resulted in more balanced budgets and less borrowing over time, the State would benefit financially from higher credit ratings and lower debt-service costs."

Therefore, with this new direction on how the State would address its annual budgets and, coupled with the fact that both this measure and Proposition 57 must pass for each to go into effect, staff recommends support for Proposition 58.