SANTA BARBARA COUNTY
BOARD AGENDA LETTER

Clerk of the Board of Supervisors
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Agenda Number:	
Prepared on:	5/16/03
Department Name:	CAO
Department No.:	012
Agenda Date:	5/27/03
Placement:	Departmental
Estimate Time:	30 Minutes
Continued Item:	NO
If Yes, date from:	

TO: Board of Supervisors

FROM: Michael F. Brown
County Administrator

STAFF CONTACT: Ken Masuda, Budget & Research Director
Lori Norton, Analyst

SUBJECT: State Budget Update - May Revise

Recommendation(s):

That the Board of Supervisors:

1. Receive a report on the status of the State Budget, including the Governor's May Revise proposals and their potential impact on Santa Barbara County.

Alignment with Board Strategic Plan:

The Recommendation is aligned with the County's Strategic Goal # 1 Efficient Government - An efficient Government able to anticipate and respond effectively to the needs of the community.

Executive Summary and Discussion:

State Budget Update

January Proposal

On January 10, the Governor released the proposed State Budget for FY 03-04. The proposed State Budget included recommended tax increases and program cuts, designed to address the State's projected $34.6 billion dollar deficit. The January proposal included recommended FY 02-03 Mid-Year reductions of $10.2 billion and an additional $24.4 billion in recommended FY 03-04 reductions.

Since January, the Legislature has taken action to implement approximately $7 billion in FY 02-03 Mid-Year reductions. Mid-Year reductions enacted include the deferral of Proposition 98 payments to the schools ($3.3 billion) as well as a variety of program cuts, unspent fund reversions, transfers, borrowing, etc. totaling approximately \$3.6 billion. Included in the FY 02-03 savings is approximately \$700 million realized through the authorization of \$2.0 billion in pension obligation bonds. The issuance of the pension obligation bonds relieved the State of making a payment, utilizing General Fund revenue, in FY 02-03, thus resulting in additional savings for the current year.

May Revise

On May 14, the Governor released the "May Revise", which provides the most up-to-date information on current year State revenues and expenditures, and revised projections for State revenues and expenditures through FY 03-04. Despite Mid-Year actions taken by the legislature, the State Budget deficit has increased from \$34.6 billion to \$38.2 billion. This includes a projected \$10.7 billion deficit in the current year (FY 02-03) and a projected \$27.5 billion deficit in FY 03-04.

To address the \$38.2 billion dollar gap, the Governor is proposing to finance the current year deficit (\$10.7 billion) over a multi-year period of time. A temporary sales tax increase of ½-cent is proposed to repay the \$10.7 billion dollar debt. The strategy to spread this debt over time seems to have broad support in the Legislature. However, the temporary tax increase to finance the debt does not have the support of Republican Legislators, who continue to say they will **not** support any tax increases to balance the State Budget. The remaining \$27.5 billion projected deficit for FY 03-04 is proposed to be closed through \$18.9 billion in cuts and savings, \$6.9 billion in fund shifts, transfers, and loans, and \$1.7 billion in program realignment to local governments.

In addition to the "new" proposal to borrow and repay the FY 02-03 deficit over time, the May Revise differs substantially from the Governor's January budget proposal in the following ways:

- January budget proposal assumed the State would eliminate the vehicle license fee (VLF) backfill to local governments. May Revise assumes the State will have "insufficient funds" to transfer to the General fund for vehicle license fee offsets, effective July 1, thereby triggering the VLF rate increase to its earlier level of two percent (2%) of the vehicle values. More information on this proposal is included under the potential risks section.
- January budget proposal included deep spending / program cuts in Education, Health and Social Services. May Revise restores some of the proposed spending cuts, mainly in the areas of Education, local government, CalWORKs, SSI/SSP, and Medi-Cal.
- January budget proposal included an \$8.3 billion Realignment package that would have transferred responsibility for many Health and Social Services programs to Counties. May Revise includes a \$1.7 billion Realignment package that will transfer far fewer programs to Counties. More information on this proposal is included in a following section.

On the revenue side, the January proposal includes \$7.1 billion in new tax revenues in FY 03-04. The \$7.1 billion increase includes the \$3.1 billion VLF rate increase— back to its previous level, and \$1.7 billion in new revenue to be generated by the ½-cent sales tax increase. It also includes, as proposed in January, a new personal income tax rate of 10.3 percent (10.3%) and an increase in cigarette excise tax from the current \$0.87 per pack, to \$1.10 per pack effective July 1, 2003, increasing again to \$1.50 per pack, effective July 1, 2004. These tax increases (totaling \$1.8 billion) would be used to fund the reduced Realignment package contained in the May Revise. The remaining revenue increases are a combination of suspensions or reductions in available tax credits.

A major difference between the January proposal and the May Revise is that many of the tax increases contained within the May Revise are temporary. The sales tax increase would expire upon repayment of the deficit bonds, and the VLF trigger would expire when the State's fiscal condition improves, such that funds are available to transfer to the General Fund for vehicle license fee offsets.

It is important to remember that with the exception of the VLF trigger, these tax increases will require a 2/3 vote of the legislature, which means the Senate must secure the votes of at least two Republican Senators and the Assembly must secure the votes of at least six Republican Assembly members.

Update on State Budget Impact on the County

On February 18, 2003, the Board received a staff report, which sought to identify and quantify the potential impacts to Santa Barbara County, if the Governor's January proposal was adopted. Staff estimated FY 02-03 Mid-Year State revenue reductions of up to $13.7 million, and FY 03-04 State revenue reductions of $30.8+ million. Of those totals, the Governor's January proposal to eliminate the backfill of vehicle license fee revenue to the local governments accounted for $9 million of the potential FY 02-03 reductions, and $18 million of the FY 03-04 reductions.

In general, the May Revise contains improvements, for the County, over the January Budget proposal. However, the May Revise will still result in substantial revenue loss to the County, and is not without risk. First, the May Revision assumption that the VLF trigger will be pulled, and rates increased to vehicle owners, significantly reduces the revenue losses to the County. The County of Santa Barbara stood to loose $9 million in FY 02-03, and $18 million **annually**, if the January Budget proposal was enacted and the VLF local government backfill eliminated.

However, the current proposal still presents several risks. First, there is a significant potential that local governments will suffer a one-time loss of VLF revenue in FY 03-04 due to timing. As proposed, the May Revise eliminates VLF backfill payments to local governments effective July 1, 2003. However, it is estimated it will take a minimum of 90 days to implement the increase to vehicle owners. As proposed, the County of Santa Barbara would suffer a loss of $1.5 million monthly, or $4.5 million quarterly. Assuming the County does not receive benefit of the increase for four months, the County would loose $6 million in GF discretionary revenue in FY 03-04. Second, some Republican legislators are set to challenge the legality of increasing the VLF without a 2/3 vote of the legislature. This could result in a delay in the timing of the increase to vehicle owners. Third, the same legislators have indicated they will pursue a voter initiative to permanently eliminate the VLF if it is increased. Finally, there is an assumption that the VLF increase is temporary and will be reduced again when the State's fiscal condition improves. When that occurs, there is no guarantee that the State will continue to provide a backfill to local governments.

The following table (Table A) summarizes and compares the impacts to Santa Barbara County based on the Governor's January Proposal and the May Revise. Additional, department level detail, and any potential updated information, will be provided to the Board on May 27th. Although improved, the May Revise, if enacted, will still have a significant financial impact on the County.

Table A

Santa Barbara County Impacts Summary by Functional Area:	**Proposed FY 03-04** **January Proposal**	**Proposed FY 03-04** **May Revise**
General Revenue – VLF	**$ 18.0 million**	**$ 0 to $ 6.0 million**
Law, Justice & Public Safety	**1.6 million**	**0 .7 million**
Health & Public Assistance	**6.3 million**	**6.3 million**
Community Resources	**4.4 million**	**3.7 million**
Other County Programs	**0.5 million**	**0.5 million**
Total Impacts to County	**$ 30.8 million**	**$11.2 to $17.2 million**

Other areas of improvement include the restoration of Williamson Act property tax backfill for agricultural lands ($700,000) and the restoration of funding for a number of Public Safety Programs (approximately $850,000). In addition, the May revise proposes new funding for Public Health preparedness and responses against Bio-terrorism, SARS, West Nile Virus, etc. It is not clear how much Santa Barbara County will receive of this new funding. Finally, the May Revise does not include the proposed one-time sweep of Redevelopment ERAF Funds.

On the negative side, the May Revise continues to defer payment of SB90 mandates ($2 million annually), assumes a County share of Federal Child Support Penalty Payments ($700,000 in FY 03-04, increasing until automated child support system is operational), assumes the taking of unspent Redevelopment Agency Housing Set Aside Funds ($700,000), and continues to assume the pass through of schools portion of RDA ERAF ($ 1.8 million for the IV RDA).

Realignment – Revised Proposal

The Governor's May Revise includes a scaled back Realignment proposal, which will shift responsibility for increased cost in various Social Service and Mental Health programs to Counties. The Statewide cost impact is identified in Table B, below. Although Realigned costs are in theory offset by new revenue, the County remains concerned that Statewide or on a County by County basis, the revenues may not be sufficient to cover the Realigned costs. Staff will present any additional details available on the Realignment proposal, to the Board, on May 27th.

Table B

Governor's Revised Realignment Proposal			
Program Area:	**County Share of Cost**		**Realigned Cost**
	Current	**Proposed**	**Statewide**
Social Services			
CalWORKs Grants	2.5%	30%	$ 782 M
Cal Works Employment Services & Admin	MOE	30%	$ 359M
Adult Protective Services	MOE	100%	$ 61M
Foster Care Grants	60%	80%	$ 237 M
Foster Care Administration	30%	50%	$ 11 M
Child Welfare Services	30%	50%	$ 197 M
Child Abuse Prevention, Intervention, & Treatment	--	100%	$ 12 M
Mental Health			
Integrated Services for the Homeless	--	100%	$ 55 M
Children's System of Care	--	100%	$ 20 M
Total			**$ 1.734 Billion**

Risks

In summary, the May Revise contains many risks to the State and to the County. These are summarized below:

- The Governor, the LAO, the State Controller, and the Finance Director have all emphatically stated that State must have a budget enacted (signed by the Governor) by July 1, 2003. Failure to do so will require increased borrowing or borrowing at a higher interest rate, which in turn would require increased revenue (greater tax increases) or decreased expenditures (deeper program cuts). Further, the State, local governments, schools, and the general citizenry are at risk if a budget is not enacted on time. Under any circumstance, the State will be required to borrow funds to meet its short-term cash flow requirements and the longer-term fiscal obligations. Failure to enact a budget by July 1 may jeopardize the State's ability to borrow funds or result in lender imposed terms and conditions which may not be favorable to the State, local governments, etc.

- As proposed, the May Revise does not balance the structural deficit that exists between State revenues and expenditures. If enacted as proposed, an approximate $7 billion dollar deficit would exist in FY 04-05. The continued notion that the economy will recover, resulting in increasing revenues, and the continuation of existing level of expenditures, is not a realistic expectation. To fix the existing structural deficit will require increased revenues or decreased expenditures in FY 03-04 and beyond.

- The May Revise proposes to eliminate the VLF backfill to local governments, effective July 1, 2003. Although the May Revise also assumes the existing "trigger" will be pulled to raise the VLF to its previous 2%, there are a number of risks associated with restoring the fee to its previous level. If the increase is delayed, overturned by the Courts, voted out by the people, etc., local governments will suffer the consequences. If this occurs, the State will once again be balancing its budget at the expense of local governments.

- The May Revise proposes a reduced package of services to be realigned to local governments. However, the Governor has stated that he intends to continue to pursue a larger realignment package as part of his proposal to address the ongoing structural deficit. The County remains concerned that realigned program costs will outpace new revenues. Further, the State's proposal to collect and distribute revenues on the basis of program costs continues to present a potential risk that some Counties may not receive sufficient revenues to adequately fund their programs. Finally, although the Governor asserts the new revenues will be exempt from Proposition 98, that assertion may be challenged in the Courts.

- Although improved, the May Revise will still dramatically impact the County of Santa Barbara, particularly in the areas of Health and Human Services and Community Resources. As proposed, the County would loose between $ 11.2 million and $17.2 million in State Revenue in FY 03-04. Many of these dollars leverage Federal dollars resulting in a much greater overall loss of funding and the resulting reduction in the services.

Mandates and Service Levels:

Where known mandate and service level impacts are described within the text of the letter.

Fiscal and Facility Impacts:

No facility impacts. Fiscal impacts are described in the previous sections of the report.

CC: Department Directors
CA Deputies
CA Analysts
Employee Organizations