

SHAW/YODER/ANTWIH, INC.

1415 L Street, Suite 200
Sacramento, CA 95814
(916) 446-4656
Fax (916) 446-4318
paul@shawyoder.org

PETERSON CONSULTING, INC.

1415 L Street, Suite 200
Sacramento, CA 95814
(916) 441-4424
Fax (916) 441-2279
petersonconsult@earthlink.net

To: Sonoma County Board of Supervisors
Cc: Chris Thomas, Lori Norton, and Jim Leddy
From: Donald F. Peterson and Paul Yoder
Date: October 6, 2009
RE: Legislative Report to the Sonoma County Board of Supervisors

The Legislature has adjourned its regular session for the year. However, we anticipate the legislators will return to Sacramento for several extraordinary sessions this fall for the purposes of taking up legislation on education, water, tax reform and/or budget.

The amount of legislation reaching the Governor's desk this year is markedly less than in years' past. However, Sonoma County enjoyed another successful year of County-sponsored legislation, which is reported on below.

This year's Legislative session was focused on the Budget, as well as some major policy areas: water, energy, corrections and economic stimulus. The Legislature failed to approve needed clean-up legislation (SB 67, SB 65) to lessen the impact of the current budget on local agencies (reported on below).

Reportedly, the Legislature will return on Tuesday, October 13 and meet that week to pass the clean-up legislation needed. (Monday, October 12 is a state holiday.) On Tuesday, October 13 and Wednesday, October 14 there would be committee hearings. On Thursday, October 15, there would be floor session, where the Senate would pass SB 67 and SB 65. It is unclear at this time if the Senate will also meet in the Fifth Extraordinary Session (on education) and the likely Sixth Extraordinary Session (on the Tax Commission recommendations, which are still pending). There is no indication yet of what the Assembly's plans are at this time.

Below is a brief summary of the enacted budget, as well as a report on legislation of interest to Sonoma County and issues we anticipate the Administration and Legislature will be addressing in the months to come.

2009-2010 Budget

The Governor approved substantial budget changes on July 28, 2009, and vetoed \$489 million in General Fund appropriations. The budget package projects \$89.5 billion of revenues and transfers to the General Fund, and authorizes total General Fund spending of \$84.6 billion. The plan leaves the General Fund with an estimated reserve of \$500 million at the end of the 2009-10 fiscal year.

The current economic conditions of the State required that the Legislature make many difficult, painful, and unpopular fiscal decisions over the course of the last several months. What began as the 2008-2009 Budget discussions in January 2008 has turned into an ongoing (and seemingly endless) budget cycle. When the Legislature finally approved the 2008-2009 budget in October 2008, it was almost immediately out of balance. The Legislature returned to Sacramento in December to try and make mid-year budget reductions. The result of that effort was a legally questionable, majority-vote budget package that the Governor vetoed. Finally, in February 2009, the Legislature reached agreement on a revised 2008-2009 Budget, which included new taxes and a special election to authorize extending a sales tax, as well as borrowing from First Five and Proposition 63. The Legislature also approved the 2009-2010 Budget as part of that February budget package, realizing that the latter budget would require reopening as the State's fiscal situation deteriorated.

The May 19, 2009 special election had six statewide measures on it, placed there by the Legislature through the agreement they reached in February. The only measure to win approval was one to prohibit legislative pay raises during deficit years. The failure of the other five initiatives created an additional \$6 billion deficit in the 09-10 Budget.

The tax increases and unpopular decisions made in the February budget cycle resulted in the Assembly and Senate Republican leaders being relieved of their posts, and several members of the Legislature facing recall efforts in their districts in retribution for their votes on the February budget.

By June 2009, the State's 2009-2010 Budget (approved in February 2009) was \$23 billion out of balance. It was very clear that no budget which included new revenues would be part of the 2009-2010 Budget changes. Republicans were clear that there were no more votes for tax increases in their caucuses; the voters rejected the tax increases that were on the May 19 ballot. This gave the Legislature very limited options for how to address the budget gap: cuts and borrowing.

With the constraints described above, the Legislature closed the budget gap in July 2009. The Governor achieved a \$500 million reserve through a series of line-item vetoes he made to the Budget sent to him. He elected to make those cuts after the Assembly refused to pass legislation which would have taken nearly \$1.7 billion more (over two years) from local governments from the Highway Users Tax Account (HUTA). Failure to pass that legislation put the budget out of balance when it went to the Governor. Among the \$498 million in line item vetoes he made was the Williamson Act subventions to counties of a whopping \$24.7 million, as well as further cuts to safety net health care programs.

The State's most recent budget cuts have a very severe impact on local governments and the people whom local governments serve. Those impacts will be exacerbated if the Legislature fails to approve the clean-up legislation required to secure the local property tax revenues the State will be taking from cities, counties and special districts in December.

Revised 2009-2010 Budget

Local Government Cuts and Borrowing: \$2.7 Billion

- Suspends Proposition 1A
- Eliminates all but token funding for the Williamson Act
- Shifts \$1.7 billion of local redevelopment funds to offset state General Fund spending for education and other programs.
- Suspends various non-education local government mandates for spending reductions of \$66 million.

Health Cuts: \$2.3 Billion

- Assumes that future federal actions will reduce state Medi-Cal funding requirements by \$1 billion and additional state savings of \$323 million are achieved.
- Assumes \$284 million in savings in developmental services.
- Rejects proposal to eliminate Healthy Families Program, while reducing support by \$179 million. (The Governor subsequently approved AB 1422, which restores funding and prevents the disenrollment of over 600,000 children, and also eliminates the waiting list through 2010).
- Reduces Proposition 36 substance abuse programs by \$90 million.
- Freezes cost-of-living adjustments for long-term care providers for savings of \$76 million.
- Various other reductions, including over \$250 million of gubernatorial vetoes.

Criminal Justice: \$1.0 Billion in Cuts

- Reflects a reduction of about \$800 million in General Fund support for CDCR.
- Assumes \$50 million in savings from limiting the reimbursement rates paid to private contractors that provide medical care to inmates outside of prison.
- Reduces court funding by 10 percent for \$169 million of savings. Assumes one-day-per-month court closures.

Social Services: \$1.0 Billion in Cuts

- Reduces CalWORKs costs by \$510 million by reducing funding to counties, temporarily exempting some families from work requirements, and other measures.
- Reduces IHSS costs by \$264 million by eliminating some services for all but the most severely disabled, making the least disabled ineligible for all services,

eliminating the share-of-cost buyout program, and implementing several antifraud activities.

- Reduces funding to counties for Child Welfare Services by \$80 million.
- Rejects Governor's proposals to eliminate CalWORKs, Cash Assistance Program for Immigrants, and the California Food Assistance program.
- Eliminates requirements for statutory COLAs for CalWORKs and SSI/SSP beginning in 2010-11.

Transportation: \$0.9 Billion in Cuts

- Assumes \$562 million of higher "spillover" gasoline sales tax and related revenues will be available for General Fund uses.
- Shifts \$225 million of Home-to-School Transportation funds to pay for public transit bond debt costs.

Legislation Sponsored by Sonoma County

AB 881 (Huffman) creates the Sonoma County Regional Climate Protection Agency to assist local agencies in Sonoma County to meet greenhouse gas reduction goals. This bill has been enrolled to the Governor and a letter has been sent requesting his signature. No further action is required at this time.

SB 113 (Senate Committee on Local Government) is the Senate Local Government Committee omnibus bill. It contained a provision sponsored by the county to aid in contracting for services. This bill has been enrolled to the Governor and a letter has been sent requesting his signature. No further action is required at this time.

SB 174 (Strickland) is the Senate Public Safety Omnibus bill and contains a provision to extend the sunset by five years on a bill (SB 568, Wiggins) sponsored by Sonoma County in a previous legislative year that authorizes the county to administer physician-approved medication to mentally disordered offenders in the county jail. This measure has been signed by the Governor and Chaptered by Secretary of State - Chapter No. 35, Statutes of 2009.

SB 635 (Wiggins) authorizes the Sonoma County Board of Supervisors, upon making findings and declarations of the need for governmental oversight and coordination of domestic violence agencies, to increase fees for marriage licenses, confidential marriage licenses, and certified copies of marriage certificates, fetal death records, and death records by up to two dollars, until January 1, 2015. This bill also extends the sunset date for a similar program in Solano County by one year. This bill has been enrolled to the Governor and a letter has been sent requesting his signature.

Legislation Supported by Sonoma County

SB 678 (Leno) creates the California Community Corrections Performance Incentives Act of 2009 which would establish a system of performance-based funding to support

evidence-based practices relating to the supervision of adult felony probationers. The measure was enrolled to the Governor, and the County sent the Governor a letter requesting his signature. No further action is required at this time.

SB 676 (Wolk) eliminates statutory restrictions on several fees collected by counties. The measure was enrolled to the Governor, and the County sent the Governor a letter requesting his signature. No further action is required at this time.

AB 474 (Blumenfield) expands the authorization that allows public agencies to enter into contractual assessments to finance the installation of improvements to now include water efficiency improvements. This bill has been enrolled to the Governor and a letter has been sent requesting his signature.

Legislation Opposed by Sonoma County

AB 3X 33 (Villines) would have made substantial changes to the energy administration in California at the detriment to local governments and local land use authority. The measure was held in the Senate and no further action is needed at this time.

Other Legislation of Interest to Sonoma County

AB 45 (Blakeslee) sets up statewide standards for wind energy producers. The measure was enrolled to the Governor, and the County sent the Governor a letter requesting his signature. No further action is required at this time.

AB 64 (Krekorian) and SB 14 (Simitian) were bills to require that the State get 33% of its power from renewable resources. However, the measures also would have impacted local agencies' jurisdiction over siting renewable power. The bills were approved by the Legislature and sent to the Governor; however, the Governor has announced his intention to veto both bills because they are "overly complex." Instead, the Governor plans to pursue this increased renewable portfolio through his gubernatorial powers.

AB 566 (Nava) provides that a local government may consider the level of support that a subdivider's survey demonstrates when approving or disapproving a mobilehome park conversion to resident ownership. The measure was enrolled to the Governor, and the County sent the Governor a letter requesting his signature. No further action is required at this time.

AB 1409 (Perez) would have removed the ability of counties to use either county road commissioner contracting authority or the authority granted under the Uniform Public Construction Cost Accounting Act when determining whether to contract out construction or to perform it with county staff. The measure was stalled in the senate but is likely to be brought up again next year.

AB 1536 (Blakeslee) would have authorized a 14 year lease on oil drilling at Tranquillon Ridge (Santa Barbara coast) with an annual revenue stream of \$50M, of which "up to"

\$34M would be dedicated to the Williamson Act subvention (replacing the existing statutory General Fund obligation). The bill was held in Senate Rules and no further action is required.

SB 65 (Budget Committee) would have exempted counties with a population of less than 40,000 from the HUTA exemptions which were agreed to as part of the July 2009 Budget. There was also clean up legislation regarding the HUTA deferral timelines. The Senate failed to pass this clean-up measure. No further action is necessary.

SB 67 (Budget Committee) would have made important technical and clarifying changes to the Proposition 1A securitization agreed to as part of the July 2009 Budget. The Senate failed to pass this clean-up measure. As of this righting, the finance team assembled to assist in the securitization of Proposition 1A is working to determine how to proceed in the absence of the clean-up legislation.

SB 88 (De Saulnier) and AB 155 (Mendoza) were efforts to require local agencies to seek approval from the California Debt and Investment Advisory Committee (CDIAC) prior to filing for bankruptcy protections. Both of these measures stalled in the Senate. No further action is necessary.

SB 289 (Ducheny) requires owners of hospital buildings that are classified as nonconforming, SPC-1 buildings, (defined in regulations as a building that is at risk of collapse in an earthquake), who have requested extensions of the 2008 deadline for seismic retrofitting or rebuilding, to include additional information in statutorily required reports due to the Office of Statewide Health Planning and Development (OSHPD) by June 30, 2011. The measure was placed on the inactive file. There is no further action required at this time.

SB 481 (Cox) provides that a taking of birds by a federally certified airport in compliance with a federal depredation permit for public safety purposes does not violate state fish and game laws if certain conditions are met. **The measure was enrolled to the Governor. The County may want to review the bill a final time.**

SB 782 (Yee) would create an affirmative defense to an unlawful detainer action if the court finds that (1) the tenant or his or her household member is a victim of domestic violence, sexual assault, or stalking; and (2) the notice to vacate is substantially based upon an act or acts of domestic violence, sexual assault, or stalking against the tenant or household member. This measure was held in committee. No further action is required at this time.

AB 303 (Beall) allows specified county and University of California disproportionate share hospitals that contract with the California Medical Assistance Commission to serve Medi-Cal patients to receive supplemental Medi-Cal reimbursement from the Construction and Renovation Reimbursement Program for new capital projects to meet state seismic safety deadlines for which plans have been submitted to the state after January 1, 2007 and before December 31, 2011. **The measure was enrolled to the**

Governor. The County may want to review the bill a final time and consider sending the Governor a letter requesting action consistent with the County's policies.

AB 411 (Garrick) requires health care districts that own or operate a hospital that has been denied a request for an extension of the seismic retrofit deadlines to report to the Office of Statewide Health Planning and Development, on or before March 1, 2010. This measure was stalled in the Senate. No further action is required at this time.

AB 523 (Huffman) allows the Office of Statewide Health Planning and Development to grant a two-year extension of the 2013 seismic deadline for a hospital building that is owned by a health care district, but is operated by a third party under a lease that extends at least through December 31, 2009, based on a declaration that the district has lacked, and continues to lack, unrestricted access to the hospital building for seismic planning purposes during the time of the lease. It also establishes interim deadlines and requirements the hospital must meet in order to qualify for the extension. **The measure was enrolled to the Governor. The County may want to review the bill a final time and consider sending the Governor a letter requesting action consistent with the County's policies.**

We will provide an updated report on legislation of interest to the County after the Governor has acted on all the bills sent to him. He is required to act on all regular session legislation by October 11, 2009. As he acts on any County-sponsored legislation, we will update you immediately.

We also expect to provide you with updates on special session legislation as that information becomes available. We anticipate at least two special sessions this fall: one on tax reform and one on education. There is speculation that there may also be an extraordinary sessions on Delta/Water legislation.

Looking Forward

While the national economy is beginning to show small signs of recovery, there will undoubtedly be a pronounced lag time before the State's revenues begin to grow again.

The Governor has indicated he will call a special session to commence sometime this fall, after the Commission on the 21st Century Economy gives its report to the Legislature. It is unclear what the Legislature intends to do with the suggestions even though the Governor plans to call for the special session. The Legislature is under no obligation to pass legislation in a special session, even if the Governor calls one. The Legislature is only required to conduct an organization session.

In addition to dealing with an overwhelmingly negative fiscal situation, the Legislature is also actively trying to address the ecological crisis occurring in the Sacramento-San Joaquin Delta. This has all the elements of high political drama because of the current, three-year long drought, as well as the North-South tension over water exports, and major

local government concerns regarding their role in any new Delta governance and management plan.

The Governor and Legislature are grappling with how to deal with the prisoner overcrowding issue since a Federal three-judge panel has ordered the state to reduce the State's prison population by over 40,000 prisoners. The most recent budget changes included a \$1.2 billion reduction to the Corrections budget. After the budget was passed, the Legislature approved legislation which only achieves part of those savings. Further, the prison population reduction that the Legislature agreed to at the end of the session does not achieve the level of population reductions ordered by the three judge panel. The Governor filed his plan on population reduction on September 18, and his plan indicated that the Legislature would have to approve more changes to achieve the reduction target; the Legislature has already rejected those changes, so it is unclear how the Governor will convince the Legislature to now approve them. This is a controversial and heated issue area, and it is proving difficult to reach agreement on how to reduce the population and make the budget reductions. The Legislature will undoubtedly be addressing this issue in 2010, if not before in a special session.

Even as the State may show signs of recovery, a report recently published by the Legislative Analyst's Office paints a grim financial future for California's liabilities:

Budget-Related Liabilities

These liabilities—consisting of budgetary deferrals and loans—total about \$35 billion.

Employee Pay and Benefit Deferrals. The July 2009 budget package includes a one day delay of the June 2010 payroll to July 1, 2010. This delay will defer approximately \$0.9 billion of General Fund expenses from 2009-10 to 2010-11.

Proposition 98 Deferrals. In recent years, the Legislature increasingly has resorted to deferring payment of Proposition 98 expenses to the subsequent fiscal year. About \$6.3 billion of such deferrals were included in the 2009-10 budget package, as recently amended by the Legislature.

Special Fund Budgetary Loan Repayments. In addition to special fund cash-flow borrowing, the General Fund also undertakes budgetary borrowing from special funds. Unlike cash-flow borrowing, these budgetary loans generally remain outstanding for several years. These General Fund repayment obligations to the state's various special funds currently total around \$2 billion.

Mandate Reimbursements. Currently, the state owes about \$1 billion to local governments (excluding school and community college districts) for mandate claims and about \$1.5 billion for education-related mandates.

Quality Education Investment Act (QEIA) Obligations. The Legislature created QEIA in response to a settlement the administration reached with the California Teachers' Association regarding the suspension of Proposition 98 that occurred in 2004-05.

Currently, about \$2.1 billion of QEIA obligations remain outstanding to be repaid in future fiscal years.

K-12 Revenue Limits and Proposition 98 Maintenance Factor. The state has a statutory obligation to pay school districts \$7.3 billion in “deficit factor” revenue limit payments in future years. (These arose from the state not making statutorily required payments— for example, by foregoing a cost-of-living adjustment in recent years.) In addition, in the July budget package, the Legislature committed the state to make \$11.2 billion in future “maintenance factor” payments to education as a result of funding reductions in 2008-09. These obligations, however, are not cumulative, inasmuch as the Legislature could choose to meet its maintenance factor obligations in the future by reducing its revenue limit obligations.

Proposition 1A Repayments. The July 2009 budget package borrows local property taxes in the amount of \$2 billion, to be repaid with interest within three years pursuant to a constitutional requirement.

Economic Recovery Bonds (ERBs). Authorized by Proposition 57 of 2004, ERBs were used to retire accumulated General Fund deficits from earlier in the decade. About \$8 billion of outstanding ERBs remain.

Infrastructure-Related Liabilities These liabilities—consisting of the state’s major categories of bonded indebtedness— total about \$69 billion.

GO Bonds. Used principally for infrastructure purposes, GO bonds currently are outstanding in the amount of \$61 billion. They are paid principally from the General Fund.

LRBs. Used mainly for construction of state facilities, LRBs currently are outstanding in the amount of \$8 billion and are paid principally from the General Fund.

Retirement-Related Liabilities

Retirement-related liabilities to be paid by the state’s General Fund are difficult to quantify precisely for several reasons discussed below. In total, unfunded retirement related liabilities of entities connected with the state exceed \$100 billion. Because of recent investment value declines for retirement systems, these unfunded liabilities may actually exceed \$130 billion once the declines are fully incorporated into the systems’ actuarial valuations.

California Public Employees’ Retirement System (CalPERS). The state—along with school districts and other local governments—participates in CalPERS’ Public Employees’ Retirement Fund (PERF). As of June 30, 2008, the state’s share of the PERF’s assets was valued at \$89 billion on an actuarial basis, and the state’s share of the PERF’s accrued pension liabilities was estimated to be \$108 billion. This means the state’s unfunded actuarial accrued liability (UAAL) in the PERF totaled about \$18 billion. In addition to the PERF, UAALs also exist in the Judges’ Retirement Funds

administered by CalPERS totaling around \$2.9 billion. There is no UAAL in the Legislators' Retirement System, which was essentially closed when voters prohibited legislators from earning state retirement benefits beginning in 1990. Accordingly, the state's share of CalPERS' UAALs totaled around \$21 billion as of June 30, 2008. A significant share of these liabilities—perhaps over 40 percent—are likely to be paid from state funds other than the General Fund.

California State Teachers' Retirement System (CalSTRS). As of June 30, 2007, CalSTRS' UAAL totaled \$21 billion. Under current law, the state, school districts, and teachers and administrators contribute to CalSTRS to cover the normal cost of accruing pension benefits, as well as a part of the costs to amortize CalSTRS' UAAL. Accordingly, it is difficult to predict precisely what portion of the UAAL will be paid by the state and which will be paid by school districts or employees. Because the state has funding responsibilities, however, for school districts, it is likely that a significant portion of these costs will be borne by the General Fund either directly (through continued state contributions) or indirectly (through payments to school districts).

State Retiree Health Benefits. As of June 30, 2008, the state's UAAL for state government and California State University retiree health benefits totaled \$48 billion. The state pays for these benefits on a "pay-as-you-go" basis and has never set aside funds to begin to retire unfunded accrued liabilities from prior years. As with pension liabilities, a significant portion of these liabilities is likely to be paid from state funds outside of the General Fund.

University of California (UC) Retirement Benefits. As of July 1, 2008, the actuarial value of assets for UC's pension plan was \$44 billion, and the actuarial value of its liabilities was \$43 billion. While the resulting actuarial surplus of over \$1 billion seems like good news, it is important to remember that neither UC employees nor the university nor the state have contributed significant funds to the plan since 1990. The combined effects of this continuing funding holiday and the recent investment market declines mean that the plan's July 1, 2009 valuation will reveal a UAAL for the system for the first time since 1987. As part of the February 2009 budget package, the Legislature indicated its intent not to provide contributions to the UC plan in the future, but did not specify how UC should fund the significant UAALs that will emerge shortly and likely grow substantially thereafter. In addition to the issues with UC's pension plan, UC—like the state and most other state and local governments—has typically paid retiree health benefits on a pay-as-you-go basis and has a \$13 billion UAAL for these benefits.

Effects of 2008-09 Investment Market Declines. There are various difficulties in quantifying the state General Fund's share of retirement-related liabilities and these difficulties have increased recently due to the large declines of stock market, real estate, private equity, and other investment values during 2008-09. The preliminary report of returns for CalPERS' portfolio in 2008-09, for example, showed that the system's asset value declined by 23.4 percent during the fiscal year. Once fully included in CalPERS' UAAL calculations, this could increase the state's share of PERF liabilities by as much as \$20 billion. Similarly, CalSTRS' UAAL could increase by over \$10 billion, and the

market declines will contribute to the reemergence of a UAAL for UC's pension plan. The state will begin to pay higher contributions to CalPERS and CalSTRS in 2010-11 to begin to retire unfunded liabilities resulting from the 2008-09 market losses.

While certain liabilities are difficult to quantify precisely, *it appears the state has over \$200 billion of short-term, longer-term, and retirement-related liabilities to retire in future years.* These liabilities will continue to put pressure on the state's finances for years to come.