City of Long Beach
Working Together to Serve

Memorandum
ATTACHMENT C

Date: May 26, 2011

To: State Legislation Committee Members

From: Patrick H. West, City Manager

Subject: **FY 12 State Budget Update – May Revise**

Introduction

Annually, the Governor of California is required to produce a budget for the upcoming fiscal year in January. The Governor then updates revenue and expenditure projections along with any programmatic changes in a May Revise before the state budget is constitutionally required to be passed by June 15th.

Overview

On May 16, 2011, Governor Jerry Brown released his May Revision to the FY 12 State Budget. This updated proposal reflects an expectation that General Fund revenues will be higher than original estimates by $6.6 billion for FY 12. The May Revision also shows a decrease in the estimated budget gap due to reductions approved by the Legislature in March 2011. Those reductions are expected to save the state approximately $13.4 billion in FY 12. Combined with $6.6 billion in higher than anticipated personal income tax and capital gains revenues, the Governor's Office estimates a decrease in the state's projected budget deficit from $26.6 billion, as reported back in January, to $9.6 billion. A summary of this deficit reduction, and corresponding budget solution is below:

Original Budget Shortfall	**$26.6 billion**
Solutions Already Enacted	- $11.0 billion
Higher Revenues	- $ 6.6 billion
Higher Spending	$ 2.0 billion
Proposition 10 Litigation	$ 1.0 billion
Deficit Under Current Law	**$12.0 billion**
Solutions Pending Legislation	- $ 2.4 billion
Remaining May Revision Budget Shortfall	**$ 9.6 billion**
Reserve Funds	$ 1.2 billion
BUDGET SOLUTIONS NEEDED	**$10.8 billion**

As a result of updated projections, the May Revise will aim to achieve $10.8 billion in budget solutions in FY 12. These cuts would close a $9.6 billion deficit and establish a $1.2 billion reserve by June 30, 2012.

May Revision Budget Solutions

The Governor plans to achieve $8.6 billion in budget solutions by passing four tax extensions, three of which would go into effect for the 2011-2015 tax years, and one to begin in 2012 and extend through 2015. In order to pass the tax extensions, the Governor needs the Legislature to approve his proposed ballot measures to allow California voters to consider the extensions.

In addition to extending existing higher tax rates, the Governor has proposed further cuts to his budget. These cuts would save the state an approximate $2.26 billion by:

- Eliminating 43 State boards, commissions, and task forces;
- Merging the Healthy Families Program into the State's Medi-Cal Program; and
- Reducing over 5,000 State positions.

Though significant cuts have already been enacted, and more have been proposed, the Governor has not backed down from his "realignment" proposal, which includes transferring state prisoners to county jails.

Additionally, the Governor's proposal to eliminate Redevelopment Agencies across the state is still an active part of his proposals to eliminate the FY 12 deficit.

Budget Highlights

- **Proposed Tax Extensions.** The May Revision proposes to maintain the current level of tax rates for Sales and Use Tax (SUT) and Vehicle License Fee (VLF) for five years, as well as the dependent exemption credit for five years. Given the current, higher-than-expected revenue situation and the difficulty in changing the income tax halfway through the tax year, the May Revise does not seek the .25 percent personal income surcharge for 2011, but would reinstate it for the 2012 through 2015 tax years. Together these extensions would generate $8.3 billion in FY 12. The Governor is asking the Legislature to vote to extend these taxes temporarily, followed by a vote of the people at a later date.
- **Redevelopment.** The Governor's proposal to eliminate Redevelopment Agencies across the state remains intact with no changes. The May Revise continues to expect $1.7 billion in funds for the State General Fund, despite the recent legal opinion from Legislative Counsel that the proposal violates the State Constitution.
- **Enterprise Zones.** The Governor originally proposed to eliminate Enterprise Zone program, saving $924 million. The May Revise modifies this proposal to preserve the Enterprise Zone Program, but to enact

significant policy changes to limit the program only to new net jobs (as opposed to generating credits for employees hired). Taxpayers would receive a $5,000 credit for each net new employee hired, and retro-vouchering would be eliminated. City staff will be examining the proposal as more details arise, but there are some areas of concern with this approach such as the following.

- Limiting the hiring credit to new hires repeals current eligibility requirements. The existing requirements focus on hiring disadvantaged individuals from low-income neighborhoods or those facing significant barriers to employment. The new proposal would only allow credits for hiring net new employees, decreasing opportunity to help low-income workers find placement with employers who are hiring.
- The number of hiring credit vouchers that Long Beach issues to local businesses will decrease significantly. In 2010 Long Beach issued over 8,200 hiring credit vouchers to nearly 700 businesses. This change would drop the number of vouchers from thousands of vouchers to hundreds.
- Replacing the current multi-year credit with a single-year credit eliminates the objective of retaining employees and making long-term investments in businesses. Small and start-up businesses would be affected in particular, especially those that are technology based and in renewable energy sectors. Most of these companies typically do not become profitable for several years, and this change will affect their utilization of the program.
- Long Beach EZ businesses will lose any tax credits they earned prior to January 1, 2006, and they will be prohibited from carrying the credits forward to future tax years.

- **Economic Incentives.** The Governor has proposed to encourage manufacturing investment by creating a sales tax exemption for new businesses that wish to purchase equipment beginning in 2012-13. The five percent sales tax exemption for start up firms (one percent for existing firms) is designed to encourage investments in California from new businesses. This exemption does not affect the local government portion of sales tax. The May Revise also expands the current Jobs Credit, expanding a new jobs credit for small businesses. The credit will be raised from $3,000 to $4,000 and the eligibility will increase from businesses employing 20 or fewer employees to 50 or fewer.
- **Increased spending on K-12 education.** The revised budget increases funding for K-12 education by $3 billion.

- **Decrease in spending on Higher Education.** The May Revise reduces funding to the University of California (UC) and California State University (CSU) systems. Proposed is a $500 million cut to each system. Both systems have strongly opposed the budget cuts since they were announced. Further, both systems believe that if the temporary tax increases are not extended, they will each face a $1 billion cut – double the amount proposed in the May Revision.
- **Realignment.** The Governor continues to propose a significant realignment from the State to the County, and his May Revise makes minor revisions in his original proposal.
- **Public Safety.** The Governor's May Revision maintains the current level of funding for the COPS public safety grant program and booking fees reimbursement. However, that level of support is contingent on the passage of the Vehicle License Fee tax extension.
- **Health and Human Services.** Three changes to Health and Human Services programs have the potential to impact the services provided by the City's Health and Human Services Department. First, the Governor's May Revise merges the Healthy Families Program into the Medi-Cal Program to reduce costs and create a single health care program for low-income families. Second, two years ago the State had eliminated General Funds to support flu vaccine for senior health clinics. Last year the Long Beach Health and Human Services Department was able to continue those services due to the State's ability to utilize Federal dollars to continue the clinics; however, officials have not been able to identify a funding source similar in size to use in place of the eliminated General Fund funds and the supplemental federal dollars to continue the clinics into FY 12. The May Revise proposes to restore a minimal amount of funding to keep the clinics open, but they will be smaller in scope. Third, for many years the City's Health and Human Services Department has received funding from the state for teen pregnancy prevention programs through the Community Challenge Grant program. The May Revise proposes eliminating this program statewide. The current award to Long Beach for teen pregnancy prevention is $210,000.
- **Transportation.** In March 2011, the Legislature reenacted the Gas Tax Swap passed during the 2010 Legislative Session. The Swap eliminated Proposition 42 funding, and replaced it with an excise tax of 18 cents per gallon of fuel. No adverse impacts to transportation funding are expected.
- **Elimination of State Agencies and Boards/Commissions.** The May Revise eliminates 43 state boards, commissions, task forces, offices, and departments.

Long Beach will continue to communicate to our Legislators the important role Redevelopment plays in revitalizing lower-socioeconomic areas in the City. The City is actively engaged in discussions with our Legislators to secure the best possible outcome for the Long Beach Redevelopment Agency as the state budget process progresses. While the Governor's May Revise amends the Governor's previous proposal to eliminate Enterprise Zones and instead proposes reforms to the program, those reforms will have negative impacts on the program, businesses and low-income residents looking for employment. Long Beach will be closely analyzing the elements of reform as they develop and communicate the impact of these changes to our Legislators.

Please contact Tom Modica, Director of Government Affairs and Strategic Initiatives at 8-5091 if you have any questions.

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