PRIORITY

# FOCUS

Analysis, Commentary and Updates on Legislative and Policy Issues that Affect California Cities

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## LEAGUE APPLAUDS BUDGET AGREEMENT, THANKS THE GOVERNOR AND LEGISLATIVE LEADERS

The League and local government officials received a very welcome surprise on July 6, when Gov. Schwarzenegger and legislative leaders announced a budget agreement that includes full funding ($1.3 million) of Proposition 42 transportation projects, and **full**, early repayment of the $1.2 billion Vehicle License Fee (VLF) gap loan taken from cities and counties by the state in 2003. *For more, see Page 2.*

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## THE FINE PRINT…

Here is a summary of the key items in the budget affecting California cities:

- **VLF gap loan early repayment**: $1.2 billion ($491.2 million to cities)

- **Prop. 42 - city portion of local streets and roads money** ($254 million for both cities and counties; cities get half of that - $126.5 million). Additionally, another $1 billion in Prop. 42 funds will be allocated to state managed projects – many benefiting our local communities. *For more, see Page 3.*

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## EARLY REPAYMENT OF VLF GAP LOAN: A WELCOME SURPRISE FOR ALL CITIES

The announcement that the FY 2005-06 budget will include early, full repayment of the "VLF Gap Loan" is good news for cities and counties who will now receive this payment earlier than expected. The early repayment also benefits the state because it liquidates a state debt and eases some of the stress that will be felt in next year's state budget. *For more, see Page 3.*

One day later, the budget was passed by the Senate (34-4) and the Assembly (64-13), and sent to the governor for his signature. Both houses also passed the budget trailer bills. The League staff is reviewing both the budget and trailer bills to examine the details in the final language (see "The Fine Print…" for some key items for cities).

You can review the full text of the bills online at www.cacities.org. The bills are: Senate Bill (SB) 77 - Budget Bill, Assembly Bill (AB) 131 - Health Omnibus, AB 138 – Mandates, AB 139 - General Government, AB 141 - Hydrogen Highway/PIER, AB 145 - Uniform Civil Filing Fees, AB 146 - Budget Revisions, SB 62 – Transportation, SB 63 – Education, SB 64 - Boards and Commissions, SB 68 - Social Services Omnibus, SB 71 - Resources Omnibus.

While the return of Prop. 42 funding was expected – the governor had proposed it his May budget revision and the Legislature adopted it in the budget subcommittee – the VLF gap loan repayment *in full* was a big surprise. The governor had proposed an early repayment of half the loan amount, but the funding was not included in the budget package adopted by the conference committee.

The League joined with the California State Association of Counties (CSAC) in applauding the budget agreement as one that keeps faith with California voters and repays much-needed funds to California communities (for more information, see the Joint Press Release on the League's web site – www.cacities.org).

Proposition 1A, the League- and local government-sponsored constitutional amendment passed by almost 84 percent of California voters in November 2004, limited the state's ability to take or borrow local funds. The measure sent a clear signal that voters wanted local funds preserved to pay for local services.

Proposition 42 was passed in 2002 by 69 percent of statewide voters. It dedicated the sales tax on gasoline to transportation projects, including repair and maintenance of local streets and roads. But it allowed the state to shift funding to the state general fund during times of state fiscal stress. FY 2005-06 will mark the first time since Prop. 42 passed that the $1.3 billion sales tax on gas will be spent on transportation. Cities and counties will receive $254 million of that amount for local street and road maintenance projects ($126.5 million for cities). For city-by-city Prop. 42 funding information, see the League's web site – www.cacities.org.

**Full VLF Gap Loan Repayment a Welcome Surprise**

City and county officials throughout the state greeted the news that full repayment of the VLF gap loan would come one year early with surprise and enthusiasm.

"This is a win-win for the state and local governments," said League of California Cities President Pat Eklund**,** who is also a council member of the city of Novato. "It's a savings for taxpayers because it wipes this debt off the state books and it provides funds for important local services like law enforcement, firefighting and vital health services." Visit the League's web site to view city-by-city VLF gap loan amounts.

We have not yet been able to determine when the state will process the loan repayment, but will provide this information as soon as it is available. The timing is particularly critical for cities and counties that were considering securitization of their share of the gap loan by selling it to investors. (For details, see "Early Repayment of VLF Gap Loan: A Welcome Surprise for All Cities").

*Continued from Page 2 – League Applauds Budget Agreement…*

**Be Sure to Say 'Thank You!'**

City officials should be sure to thank Gov. Schwarzenegger and their legislators for their leadership, and for producing a state budget that respects the important role local governments play in providing services and rebuilding the state's infrastructure.

Be sure to also tell them how your city will be able to put the VLF gap loan repayment to work, providing services or paying for infrastructure needs in your community.

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*Continued from Page 1 – The Fine Print…*

- **Prop. 1A ERAF shift from cities** to state (-$350 million)
- **Prop. 1A ERAF shift from redevelopment agencies** to state (-$250 million)
- **No booking fee subvention** (Conference committee had proposed an appropriation of $25 million in FY 2005-06 for booking fee and VLF hardships, but this proposal was dropped in the final budget agreement. Remember: fees were capped at one-half administrative costs beginning FY 2005-06.)
- **Mandate Reimbursements** - the obligation to repay past deferred mandate payments was extended to a 15-year payback period (vs. the current statute from last year's budget that said five-year payback). This budget also includes changes that would exempt the state from reimbursable mandate claims for specific Brown Act activities, an estimated cost to local governments and schools of approximately $21 million in FY 2005-06.

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*Continued from Page 1 – Early Repayment of VLF Gap Loan…*

Who would have predicted that the loan would be repaid early? Just six months ago, fueled by the state's past record of borrowing from local government, many questioned whether the loan would be repaid at all. Even when the governor's May budget revision included early repayment of half of the amount, many observers expected the proposal to be rejected by the Legislature.

It is well known that nearly 150 cities and counties securitized the VLF gap loan by selling to investors Notes secured by the state's promise to repay. These cities and counties received funds early last spring, but had to accept a discount ranging from 4 percent to 10 percent, depending upon amounts and circumstances for each agency. In all, over $650 million of the $1.2 billion was securitized, including Los Angeles County's stand-alone securitization. The securitization for all other cities and counties was accomplished through California Communities, the joint powers authority sponsored by the League and the California State Association of Counties.

Now that repayment will come early, what happens to the cities and counties that sold their right to receive payments from the state? As it turns out, they'll be winners, too. Many of these agencies received the funds when they were needed to address budget issues in FY 2004-05. And the early repayment means there will be additional interest earnings, above what will be needed to repay the notes. The discounts that local agencies had to accept will be made up or will shrink considerably.

The repayment funds for the securitized agencies will be invested until the date the notes mature on November 15, 2006. At that time, investors will be paid for the notes they hold. Residual funds, including the unexpected interest earned from the early repayment, will be distributed on a pro rata basis to the agencies that securitized the loan. California Communities is working with bond counsel to determine whether the use of the repayment funds can be structured in a way that would allow all or a portion of this residual amount to be paid shortly after the state payment. Participants will be notified of the timing and amount of payment as soon as possible.

An additional twenty-six cities had enrolled in a second VLF gap loan financing that was scheduled to close in early August. With the new knowledge that repayment will be funded in this year's state budget, cities have an opportunity to reconsider their decision to securitize. If repayment is expected to come early in the fiscal year, something the League is still attempting to confirm, the second financing will most likely not be issued.