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March 11, 2003

To: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

STATE BUDGET REPORT

Yesterday, the Director of Finance and the State Controller released a joint legal opinion by their chief legal counsels which concludes that the Vehicle License Fee (VLF) can be increased by administrative action upon a determination that the State lacks sufficient General Fund money to fund VLF offset payments to local governments. A copy is attached. The opinion seeks to resolve some of the legal questions that have been raised regarding the functioning of the trigger provisions of the original 1998 law which in simplest terms provided for an automatic incremental reduction or increase in the VLF rate upon a determination by the Director of Finance that sufficient State funds did or did not exist to reimburse local governments for their loss of revenue from a further rate reduction or from a State budget reduction in their reimbursement.

The Legislative Analyst, among others, had suggested that subsequent amendments to the law had eliminated certain key elements of the original trigger tax framework so that it was unclear what criteria would be used to determine if "sufficient" money is available and which public official is authorized to make this determination. The legal opinion addresses the first of these uncertainties regarding the criteria to be used. However, in the course of providing the legal reasoning underlying the opinion, the authors ultimately render an opinion regarding the official who must make the determination.

The principal conclusion of the opinion is that a determination regarding the "availability" of sufficient funds to fund the VLF backfill is primarily a budgetary consideration and only secondarily a matter of the availability of General Fund cash, and that in making this determination the proceeds of all General Fund borrowing that would not be repaid in the fiscal year of the borrowing should not enter into the determination. Factors to be considered in making the determination include: revenue forecasts for the current and

budget years, actual revenues and expenditures to date, the expected disbursements for the remainder of the fiscal year, April tax receipts, and data from the May Revise.

The major points of the opinion include:

- While the original law has been modified a number of times, "the original language, which provided that the offset would be reduced if insufficient moneys were available, was never revised." For a reduction to occur, a determination of sufficiency is necessary.

- The original trigger framework relied primarily upon a revenue forecast to make the determination, not the availability of cash in any given month, so that the State need not be literally broke, as some have argued, for a determination of "insufficiency" to be made.

- In making a determination of "availability", not all claims on General Fund money are equal. Some 59.9 percent ($48 billion) of the General Fund fall within the category "higher priority" obligations such as obligations under the Constitution to support schools, to repay general obligation bonds, to reimburse advances from Special Funds, to meet obligations arising under Federal law or as a result of initiative statutes.

- With respect to the remainder of the General Fund obligations with "equal priority", the VLF offset payments are essentially last among equals with the least claim on available funds. Otherwise the trigger framework would not function as a counter measure to a budget shortfall which was the intent of the original law.

- Short term borrowing between fiscal years, as the State will need to do to get through the current year, should not be considered in making a determination of "insufficiency" because to do so would result in borrowing to pay the offset and eliminate its utility as a counter measure to a budget shortfall.

- "Both the language of the statute and the history of its execution place the responsibility for making factual determination of budget conditions in the Department of Finance." Once the Department has determined that the budget and cash preconditions for continuing the offset cannot be met, it must give notice to the Departments of Motor Vehicles and Housing and Community Development. At that point, the Controller must discontinue offset payments to local governments, except that "he may advance such sums as necessary during the transition until the statutorily triggered revenues flow to local government."

Since the opinion mentions the May Revise as one of the factors to be considered in making a determination of "insufficiency", it is likely that a determination will be made at that time. Given that the State will have to borrow between $6 billion and $11 billion short term to get through this fiscal year, the determination of "insufficiency" should not be difficult. If the VLF were to return to the original 2 percent rate starting July 1, 2003, the State would realize approximately $4 billion in savings in the budget year. However, because current law requires that VLF notices be sent to vehicle owners 64 days in advance, there may be some delay in realizing the savings unless the law is changed.

It is possible under current law, as interpreted by this opinion, for the Director of Finance to determine that the State can afford a part of the offset, thereby providing for a VLF rate of less than 2 percent, with the balance to be made up through a smaller offset. The Governor and the Legislature could agree to eliminate the remaining backfill in order to ensure that local governments are part of the budget solution. Republican legislators have responded to the opinion by suggesting they will take legal action to reverse an increase in the VLF, as well as an initiative effort to repeal the entire VLF.

We will continue to keep you advised.

DEJ:GK
MAL:JR:ib

Attachment

c: Executive Officer, Board of Supervisors
County Counsel
Local 660
All Department Heads
Legislative Strategist
Coalition of County Unions
California Contract Cities Association
Independent Cities Association
League of California Cities
City Managers Associations
Buddy Program Participants