MWD

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

REVISED

May 18, 1993

To: Board of Directors (Executive Committee--Action)
(Special Committee on Legislation--Action)

From: General Manager

Subject: State Budget Policy Principles

Report

The deliberations and resolution of the 1992-93 State budget concluded after a long and arduous process. The $57.4 billion spending plan provided for just over $40 billion in State General Fund expenditures -- about $2.3 billion less than General Fund spending in the prior budget year. Most General Fund departments suffered a 15 percent funding reduction, while special fund departments were cut by 10 percent.

The Governor's budget plan for the 1993-94 fiscal year, released in January, substantially relies on further government spending reductions in order to address a then-estimated $7.5 billion deficit. According to the Governor, the 1993-94 budget plan is balanced; contains no new taxes; relies on expiration of the temporary sales tax; and contains no deficit spending or rollover from FY 93-94 to FY 94-95. General Fund spending is reportedly 8.5 percent below current-year levels.

After analyzing the Governor's January plan, Legislative Analyst Elizabeth Hill reported the spending plan is based on risky assumptions and does not address the State's long-term fiscal dilemma. The Governor's plan assumes a substantial contribution from the federal government to defray health and welfare services for undocumented and legalized immigrants; requires a cut in welfare benefits; and elimination of the renter's tax credit. Without those components in place, current estimates are that the 1993-94 budget proposal will be out-of-balance to the tune of $9.2 billion due to increased Medi-Cal caseloads and a continual drop in anticipated State revenues.

The Department of Finance has indicated that the January revenue projections are not materializing and spending reductions beyond the January budget plan will be necessary. In late May, the Department of Finance will release the "May Revise" which will update the status of State revenues and expenditures, along with caseload growth.

I. 1992-93 State Budget Clean-Up

Background: A component of the 1992-93 budget solution was a shift of local government property taxes to school and community college districts in the amount of $1.3 billion - $375 million of which was to come from special districts. Efforts were made to spell out the types of debt for which pledged property tax revenues could be excluded. An exemption from the property tax shift for multi-county special districts was also adopted.

Several legislative proposals have surfaced during the 1993-94 legislative session to clarify the intent of the debt service exemptions under the 1992-93 property tax shift. Legislative efforts to further clarify "revenues pledged to debt service;" to define "debt instrument;" and to protect the multi-county exemption may result in less revenues of an unknown amount being shifted from special districts to K-14 schools. The Department of Finance has already indicated that the 1992-93 shift of property tax revenues from special districts may be $200 million short of the $375 million target as a result of the exemptions currently in law. Consequently, the State General Fund may be subject to offsetting this shortfall, or an adjustment may be sought from special districts by legislation or as part of the 1993-94 State budget resolution.

Metropolitan's property tax revenues are used only to repay (1) the District's voter-approved general obligation bonds which were sold to finance facilities that provide water to Southern California (including the Colorado River Aqueduct and Metropolitan's distribution system); and (2) that portion of Metropolitan's payments under the State Water Contract which are pledged to repay bonds issued to finance the State Water Project facilities which benefit the District.

Metropolitan has a direct covenant with its bondholders to secure its voter-approved general obligation bonds with property tax revenues. Case law also recognizes that holders of the State's bonds issued to finance construction of the State Water Project relied on the covenant of Metropolitan to pledge property tax revenues to repay the bonds issued to finance that portion of the State Water Project which benefits the District. In the event, the proposed property tax shift diverts revenues beyond the Proposition 13 "bailout," Metropolitan's property tax revenues pledged for payments of its general obligation bonds or under the State Water Contract should not be subject to the shift because forcing such a shift would impair contracts with existing holders in contravention of the "contracts" clause of the U.S. Constitution.

Metropolitan's property tax revenues are also protected under the "debt service" protections and the multi-county exemption enacted into law last fall. Property tax revenues not pledged to debt retirement for many of Metropolitan's member agencies and subagencies, however, fell subject to the shift which resulted in significant impacts to those agencies. As a result of last year's property tax shift, many local governments are scaling back their infrastructure programs in response to uncertain revenue streams.

Financial markets place a premium on the stability and predictability of governmental revenues. As outlined in a report by the California Debt Advisory Commission, California's fiscal situation is causing financial markets to demand higher yields, increased security provisions and higher coverage ratios on certain financing mechanisms. The cost of capital is increasing for California local governments.

Deteriorating credit quality is not the only factor inhibiting debt issuance. Even when bonds can be issued, many agencies cannot find revenues in their budgets to operate the new facilities. A decrease in local infrastructure investment will undoubtedly diminish the State's competitiveness and further delay economic recovery.

Policy Options:

a. Support legislation that clarifies the debt service protections and maintains the multi-county exemption for special district property tax revenues subject to the shift in the 1992-93 State budget. Coordinate advocacy efforts through local government coalitions and associations.

b. Oppose legislation to protect property tax revenues pledged to debt service and efforts to maintain the multi-county exemption as these protections may threaten the amount of property tax revenues necessary to balance the 1992-93 State budget.

c. Monitor legislation to clarify debt service protections and to maintain the multi-county exemption enacted to resolve the 1992-93 State budget but take no "official" position on the issue.

Recommendation: Adopt Policy Option I(a).

II. **Shift of Special Funds**

Background: Last year SB 1565 would have transferred $150 million annually from the State Water Project to the State General Fund purportedly to "defray the uncompensated costs for environmental and economic damages caused to fish and wildlife in the State." With the help of MWD's member agencies, Kern County Water Agency, Tulare Lake Basin WSD, California Farm Bureau, Western Growers, and ACWA, we were able to use the legal and constitutional questions to convince legislators to kill the proposal.

Policy Options:

a. Oppose efforts to transfer any proposed State Water Project revenues to the State General Fund as such action impairs existing contracts by the State and the State Water Contractors and between the State and its bondholders. Coordinate advocacy efforts through local government coalitions and associations.

b. Support efforts to transfer any proposed State Water Project revenues to the State General Fund to assist in retiring the State General Fund deficit for 1993-94.

c. Take no action on any proposed transfer of State Water Project Revenues to the State General Fund.

Recommendation: Adopt Policy Option II(a).

III. **Colorado River Board Funding**

Background: Last year a bill opposed by Metropolitan's Board, SB 1697 by Senator Ed Royce (R-Anaheim), would have abolished the Colorado River Board, the Coastal Commission, the Energy Resources and Development Commission and the Arts Council. Because of the Colorado River Board's importance in facilitating discussions among California interests, as well as the critical role the Board plays in interstate, federal and international discussions, Metropolitan, and other groups, were successful in having the bill referred to interim study. Despite earlier efforts in the 1992-93 State budget to eliminate the State's contribution to fund activities of the Colorado River Board, the final budget bill contained a $247,500 appropriation for Colorado River Board support.

The Governor's 1993-94 budget proposes to fund the Colorado River Board at a 12 percent decrease over their 1992-93 allocation.

Policy Options:

a. Directly oppose efforts to eliminate the State's contribution to fund activities of the Colorado River Board in light of the Colorado River Board's importance in facilitating discussions among California interests, as well as the critical role the Board plays in interstate, federal and international discussions. Coordinate advocacy efforts through local government coalitions and associations to promote Metropolitan's position.

b. Directly support efforts to eliminate any financial contribution by the State to fund activities of the Colorado River Board leaving funding to the six public agencies represented on the Colorado River Board.

c. Take no action on any effort to eliminate the State's contribution to fund activities of the Colorado River Board.

Recommendation: Adopt Policy Option III(a).

IV. 1993-94 State Budget Proposals

Background: The Governor's 1993-94 budget proposal ends the post-Proposition 13 fiscal relief provided to counties, cities and special districts. The Governor's plan proposes to shift a total of $2.595 billion in property tax revenue from counties, cities, special districts and redevelopment agencies to relieve the State's General Fund contribution to K-14 schools. The Governor proposes that the $2.075 billion shift from cities, counties and special districts be allocated among local governments by a methodology to be developed by the State working jointly with local governments.

The Governor's budget plan specifically sets forth that $150 million in property tax revenues from enterprise special districts be transferred to the State General Fund. This amount purportedly represents the current estimate of property tax revenue that is subsidizing enterprise functions which, the Governor believes by definition, should be self-supporting from charges for services. Transit and hospital districts are excluded from this proposal. The Legislative Analyst has indicated that the transfer from enterprise special districts could be in error in either direction by a range of tens of millions of dollars.

The Governor has described his revenue reallocation plan as a recall of the post-Proposition 13 "bailout funding." The shift would essentially eliminate the remaining 60 percent of State "bailout" money plus historic property tax revenues from many special districts that never received State bailout funds. In the event, the proposed property tax shift does in fact divert revenues beyond the Proposition 13 "bailout," Metropolitan's property tax revenues pledged for payments of its general obligation bonds or under the State Water Contract should not be subject to the shift because forcing such a shift would impair contracts with existing holders in contravention of the "contracts" clause of the U.S. Constitution.

From her analysis of the Governor's 1993-94 budget plan, Legislative Analyst Elizabeth Hill has indicated that although K-14 schools would receive MORE property tax dollars under the Governor's plan, total revenues for K-14 education would NOT increase because the Administration proposes to decrease the State's funding for K-14 education on a dollar-for-dollar basis.

The combined impact of last year's property tax shift and the proposed shift for 1993-94 translates to a 31 percent loss of property tax revenues by local governments statewide or a 5.8 percent loss of total local government revenues over the two-year period.

It appears inevitable that some portion of the 1993-94 budget solution will be borne by local governments despite the fact that the variable dependence upon property tax by local governments will complicate the allocation of any further property tax reduction. While local governments have some authority to levy assessments or charge fees, those revenue sources may not be sufficient to offset further property tax losses. Most local governments with authority to levy benefit assessment or user charges can only recapture the cost of providing a specific benefit to a group of property owners or service users.

<u>Policy Options</u>:

a. Oppose legislation to shift further property tax revenues from special districts, including the $150 million in property tax revenues from enterprise special districts. In the event the property tax shift from special districts is enacted, support efforts to secure the same protections for property tax revenues pledged to debt as proposed for the 1992-93 special district property tax shift.

b. Support legislation to shift the balance of property tax revenues allocated to special districts to the State General Fund to assist with the retiring of the State General Fund deficit for 1993-94.

c. Monitor legislation to shift the property tax revenues allocated to special districts to the State General Fund as part of the 1993-94 State budget resolution but take no "official" position on the issue.

Recommendation: Adopt Policy Option IV(a).

V. Special District Consolidation

Background: There are approximately 1,780 independent special districts in California - - 866 of which are water-related special districts. Procedures for establishing and revising local government boundaries are set forth in the California Constitution and codes of law. Generally, LAFCO proceedings occur first and include actions taken from the filing of an application for a boundary change proposal through final action on the application. If a LAFCO approves a proposal, proceedings are conducted by a city, county or special district whose boundaries would be changed or by the county for city incorporation and certain reorganizations.

State Treasurer Kathleen Brown has publicly recommended that the Legislature examine local government consolidation to promote greater efficiencies while including financial incentives to encourage local governments to achieve more streamlined and efficient operations.

The Legislative Analyst has strongly recommended in her budget analysis that there be a fundamental restructuring of state and local government although acknowledging that a fundamental restructuring will take time and will not solve the State's fiscal problems overnight. The Legislative Analyst feels quite strongly that the Legislature should make governmental restructuring one of their highest priorities. A key part of her recommendation includes giving local governments a larger share of property tax revenues while allowing the State to keep sales tax revenues now distributed to local governments.

The battle cry from legislators for special district consolidation has been answered this legislative session by Assemblyman Sam Farr (D-Carmel) and Assemblyman Mike Gotch (D-San Diego).

AB 491 by Assemblyman Farr would allow LAFCOs to initiate proposals for consolidation of districts, dissolution, merger or establishment of a subsidiary district. The author has convened a working group of special district representatives and LAFCO representatives to address concerns relating to LAFCO-initiated district reorganizations. ACWA and the California Special Districts Association are active participants in this working group.

AB 1335 by Assemblyman Gotch requires LAFCOs to adopt "development and conservation tiers" for each urban area by January 1, 1995, and prohibits certain financing mechanisms outside these tiers without LAFCO approval. The bill also allows LAFCOs to initiate proposals relating to special district consolidation, dissolution, merger, or establishment of a subsidiary district. The bill requires a LAFCO to order these actions without an election, except when a 25 percent protest exists.

<u>Policy Options</u>:

a. Do not oppose legislative efforts to simplify and facilitate special district consolidations but ensure that legislation provides mechanisms to identify the most efficient and economical path to provide better service to the public without duplication of services. Coordinate advocacy efforts through local government coalitions and associations to ensure:

* Special district representation on LAFCOs;
* Adequate conflict resolution procedures;
* That LAFCO consider better intergovernmental coordination mechanisms rather than immediate consolidation as one alternative in the consolidation analysis, particularly between local governments and special districts;
* That LAFCO consider economic and service delivery impacts under proposed consolidation;
* An equitable manner to allocate costs associated with LAFCO-initiated proposals;

* Financial incentives for reorganization and restructuring;

* Exemptions for multi-county special districts; and

* Consolidations of only "like" districts.

b. Oppose legislation which would facilitate special district consolidations.

c. Monitor legislation on special district consolidation but take no "official" position on the issue.

Recommendation: Adopt Policy Option V(a).

Board Committee Assignments:

This letter is referred for action to:

The Executive Committee because of its authority with regard to legislation sponsored by the District or in any way affecting the District, pursuant to Administrative Code Section 2417; and

The Special Committee on Legislation because of its authority to review proposals for state and federal legislation that may affect the District, pursuant to Administrative Code Section 2581(a).

for RWBalcerzak
General Manager

KMC:REC:AEB